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FEDERAL TELECOMMUNICATIONS POLICY ACT OF 1986

HEARINGS

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 2565

TO ENSURE THE ORDERLY AND COMPETITIVE DEVELOPMENT OF THE TELECOMMUNICATIONS INDUSTRY

SEPTEMBER 10 AND 16, 1986

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FEDERAL TELECOMMUNICATIONS POLICY ACT OF 1986

WEDNESDAY, SEPTEMBER 10, 1986

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to notice, at 9:35 a.m. in room SR-253, Russell Senate Office Building, Hon. John C. Danforth (chairman of the committee) presiding.

Staff members assigned to this hearing: Regina Keeney, staff counsel and Tom Cohen, minority staff counsel.

The CHAIRMAN. We are delighted to have as the first witness on his bill the majority leader, who has introduced S. 2565, the Telecommunications Policy Act of 1986, obviously addressing a question of great concern. Witness the number of people present today.

And Senator Dole, thank you very much.

[The bill follows:]

99TH CONGRESS
2D SESSION

S. 2565

To ensure the orderly and competitive development of the telecommunications industry.

IN THE SENATE OF THE UNITED STATES

JUNE 18 (legislative day, JUNE 16), 1986

Mr. DOLE introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

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A BILL

To ensure the orderly and competitive development of the telecommunications industry.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Federal Telecommunications Policy Act of 1986".

TITLE I

SEC. 101. PURPOSE OF LEGISLATION.

In order to ensure the orderly and competitive development of this Nation's telecommunications industry, the Congress deems it necessary and appropriate for the Federal Communications Commission, in accordance with the public interest as set forth in title II of the Communications Act of 1934, as amended (47 U.S.C. 201-224), to promulgate and implement the regulations set forth in title II of this Act.

TITLE II

SEC. 201. ADOPTION BY COMMISSION OF REGULATIONS CONCERNING CLASS I AND CLASS II LOCAL TELEPHONE COMPANIES AND DOMINANT INTEREXCHANGE CARRIERS.

Within thirty (30) days after the date of this Act, the Federal Communications Commission shall, without regard to the procedures otherwise required by sections 551-559 and 701-706 of title 5, United States Code (commonly referred to as the Administrative Procedure Act), adopt the following regulations concerning Class I and Class II local telephone companies and dominant interexchange carriers (as defined in such regulations), and publish such regulations in the Federal Register:

"PART A—DEFINITIONS

"SEC. 1. GENERAL DEFINITIONS.

"For the purpose of these regulations, unless the context otherwise requires—

"(a) 'Carrier' means any person deemed a carrier under the Communications Act of 1934 or amendments thereto, or, with respect to intrastate telecommunications, under the laws of any State.

"(b) 'Class I local telephone company' means any telephone company and any entities directly or indirectly owned or controlled by such telephone company or affiliated through substantial common ownership that, individually or together with such entities, was serving more than ten million five hundred thousand (10,500,000) telephone access lines on January 1, 1985.

"(c) 'Class II local telephone company' means any domestic telephone company, which provides regulated wireline exchange telecommunications and exchange access services, and its affiliated domestic telephone companies that, individually or together with its affiliate domestic telephone companies, was serving more than five million (5,000,000) and less than ten million five hundred thousand (10,500,000) telephone access lines on January 1, 1985, and any entity directly or indirectly owned or controlled by such telephone company or affiliated through substantial common ownership, but shall not include any parent company of such telephone company or any affiliate of such parent company not having an ownership interest in a domestic telephone company.

"(d) 'Commission' means the Federal Communications Commission.

"(e) 'Customer premises equipment' means equipment employed on the premises of a person (other than a carrier) to originate, route, or terminate telecommunications, but does not include equipment used to multiplex, maintain, or terminate access lines.

"(f) 'Dominant interexchange carrier' means any carrier and its affiliates, other than a Class I or Class II local telephone company, that the Commission has defined as a 'dominant carrier' pursuant to 47 C.F.R. Part 61, and that, for the last fiscal year ending prior to January 1, 1985, received annual revenues of over ten billion dollars ($10,000,000,000) from the offering of domestic message toll service, as defined in 47 C.F.R. § 31.510.

"(g) 'Electronic publishing' means the provision of any information that dominant interexchange carriers or their affiliates have, or have caused to be, originated, authored, compiled, collected, or edited, or in which they have a direct or indirect financial or proprietary interest, and that is disseminated to an unaffiliated person through some electronic means.

"(h) 'Information' means knowledge or intelligence represented by any form of writing, signs, signals, pictures, sounds, or other symbols.

"(i) 'Information access' means the provision of specialized exchange telecommunications services by a Class I or Class II local telephone company in an exchange area in connection with the origination, termination, transmission switching, forwarding, or routing of telecommunications traffic to or from the facilities of a provider of information services. Such specialized exchange telecommunications services include, where necessary, the provision of network control signaling, answer supervision, automatic calling number identification, carrier access codes, testing and maintenance of facilities, and the provision of information necessary to bill customers.

"(j) 'Person' means any individual, partnership, firm, corporation, association, or other business or legal entity.

"(k) 'Technical information' means intellectual property of all types, including, without limitation, patents, copyrights, and trade secrets, relating to planning documents, designs, specifications, standards, and practices and procedures, including employee training.

"(l) 'Telecommunications' means the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received, by means of an electromagnetic transmission medium, including all instrumentalities, facilities, apparatus, and services (including the collection, storage, forwarding, switching, and delivery of such information) essential to such transmission.

"(m) 'Telecommunications equipment' means equipment, other than customer premises equipment, used by a carrier to provide telecommunications services.

"(n) 'Telecommunications service' means the offering for hire of telecommunications facilities, or of telecommunications by means of such facilities.

"SEC. 2. DEFINITIONS RELATING TO CLASS I LOCAL TELEPHONE COMPANIES.

"For the purpose of part B of these regulations concerning Class I local telephone companies, unless the context otherwise requires—

"(a) 'Affiliate of a dominant interexchange carrier' means any organization or entity that is under direct or indirect common ownership with or control by a dominant interexchange carrier or is owned or controlled by another affiliate of such company. For the purposes of this paragraph, the terms 'ownership' and 'owned' mean a direct or indirect equity interest (or the equivalent thereof) of more than fifty (50) percent of an entity. 'Subsidiary of a dominant interexchange carrier' means any organization or entity in which a dominant interexchange carrier has stock ownership, whether or not controlled by a dominant interexchange carrier.

"(b) 'Exchange access' means the provision of exchange services for the purpose of originating or terminating interexchange telecommunications. Exchange access services include any activity or function performed by a Class I local telephone company in connection with the origination or termination of interexchange telecommunications, including but not limited to the provision of network control signaling, answer supervision, automatic calling number identification, carrier access codes, directory services, testing and maintenance of facilities, and the provision of information necessary to bill customers. Such services shall be provided by facilities in an exchange area for the transmission, switching, or routing, within the exchange area, of interexchange traffic originating or terminating within the exchange area, and shall include switching traffic within the exchange area above the end office and delivery and receipt of such traffic at a point or points within an exchange area designated by an interexchange carrier for the connection of its facilities with those of the Class I local telephone company. Such connections, at the option of the interexchange carrier, shall deliver traffic with signal quality and characteristics equal to that provided similar traffic of any dominant interexchange carrier or other nonaffiliated interexchange carrier, including equal probability of blocking, based on reasonable traffic estimates supplied by each interexchange carrier. Exchange services for exchange access shall not include the performance by any Class I local telephone company of interexchange traffic routing for any interexchange carrier.

"(c) 'Exchange area' or 'exchange' means a geographic area established by a Class I local telephone company in accordance with the following criteria:

"(1) any such area shall encompass one or more contiguous local exchange areas serving common social, economic, and other purposes, even where such configuration transcends municipal or other local governmental boundaries;

"(2) every point served by a Class I local telephone company within a State shall be included within an exchange area;

"(3) no such area which includes part or all of one standard metropolitan statistical area (or a consolidated statistical area, in the case of densely

INTENTIONAL
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populated States) shall include a substantial part of any other standard metropolitan statistical area (or a consolidated statistical area, in the case of densely populated States), unless the Commission shall otherwise allow; and

"(4) except with approval of the Commission, no exchange area located in one State shall include any point located within another State.

"(d) 'Information service' means the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information which may be conveyed via telecommunications, except that such service does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service.

"(e) 'Interexchange telecommunications' means telecommunications between a point or points located in one exchange telecommunications area and a point or points located in one or more other exchange areas or a point outside an exchange area.

"(f) 'Transmission facilities' means equipment (including without limitation wire, cable, microwave, satellite, and fiberoptics) that transmit information by electromagnetic means or which directly support such transmission, but does not include customer premises equipment.

"SEC. 3. DEFINITIONS RELATING TO CLASS II LOCAL TELEPHONE COMPANIES.

"For the purposes of part C of these regulations concerning Class II local telephone companies, unless the context otherwise requires—

"(a) 'Affiliate' or 'affiliates' means any organization or entity in which, directly or indirectly, a parent company of a Class II local telephone company has any ownership or equity interest or control.

"(b) 'Affiliated interexchange carrier' means any interexchange carrier that provides domestic interexchange telecommunications and that was acquired by the parent of a Class II local telephone company during the calendar year ending December 31, 1983.

"(c) 'Exchange access' means the provision of exchange services for the purposes of originating or terminating interexchange telecommunications. Exchange access services include any activity or function performed by a Class II local telephone company in connection with the origination or termination of interexchange telecommunications, including but not limited to the provision of network control signaling, answer supervision, automatic calling number identification, carrier access codes, directory services, testing and maintenance of facilities, and the provision of information necessary to bill customers. Such services shall be provided by facilities in an exchange or serving area for the transmission, switching, or routing, within the exchange or serving area, of interexchange traffic originating or terminating within the exchange or serving area, and, except as provided in section 10(b)(2) of these regulations, shall include switching traffic within the exchange area above the end office and delivery and receipt of such traffic at a point or points within an exchange or serving area designated by an interexchange carrier for the connection of its facilities with those of the Class II local telephone company. Such connections, at the option of the interexchange carrier, shall deliver traffic with signal quality and characteristics equal to that provided to similar traffic of any dominant interexchange carrier or any IOC, including equal probability of blocking, based on reasonable traffic estimates supplied by each interexchange carrier. Exchange services for exchange access shall not include the performance by any Class II local telephone company of interexchange traffic routing for any interexchange carrier, except that tariffed routing of traffic among multiple points of presence designated by an interexchange carrier (solely at the option of such carrier) within an exchange or serving area based on the destination of such traffic outside a Class II local telephone company's facilities (but not routing of traffic among trunk groups from an end office or access tandem to a point of presence or any routing beyond such points of presence) shall not be considered interexchange traffic routing. There shall not be more than one point of presence of any interexchange carrier at any physical location.

"(d) 'Exchange area' or 'exchange' means those geographic areas established by a Class II local telephone company within which such company has the facilities and capability (on the schedule set forth in section 10(b) of these regulations) to provide traffic switching above end offices and delivery and receive of such traffic at a point or points designated by an interexchange carrier within such exchange areas for the connection of its facilities with those of the Class II local telephone company. Additional or different exchange areas shall be established by Class II local telephone companies in the future, with the approval of the Commission, when and where the foregoing criteria are met. In addition to the foregoing, each Class II local telephone company exchange area shall meet the following criteria:

"(1) any such exchange area shall encompass one or more contiguous local exchange areas serving common social, economic, or other purposes, even where such configuration transcends municipal or other local governmental boundaries, and shall take into consideration Class I local telephone company exchange areas and associated serving areas;

"(2) no such area which includes part or all of one metropolitan statistical area (or a consolidated statistical area, in the case of densely populated States) shall include a substantial part of any other metropolitan statistical area (or consolidated statistical area, in the case of densely populated States), unless the Commission shall allow; and

"(3) except with approval of the Commission, no exchange area located in one State shall include any point located within another State.

"(e) 'Exchange telecommunications' means:

"(1) telecommunications between points within an exchange or serving area;

"(2) telecommunications between or among a point or points within a Class II local telephone company exchange or serving area and either—

"(a) a point or points within another Class II local telephone company exchange or serving area,

"(b) a point or points within the serving area of any IOC, or

"(c) a point or points within an exchange area of a Class I local telephone company if the Class II local telephone company exchange or serving area(s) and the IOC serving area are associated with the Class I local telephone company exchange area as of the date of these regulations; and

"(3) telecommunications between a point or points within a Class II local telephone company exchange or serving area and a point or points within an IOC serving area which has been associated with such Class II local telephone company exchange or serving area with the approval of the Commission as permitted by section 3(g) of these regulations.

"(f) 'Independent operating company' and 'IOC' mean any carrier, other than a dominant interexchange carrier, or a Class I or Class II local telephone company, providing exchange telecommunications and exchange access service.

"(g) 'Information service' means the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information which may be conveyed via telecommunications, except that such service does not include (1) any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service, or (2) the provision of time, weather, and such other similar audio services that are offered by any Class II local telephone company as of the date of these regulations.

"(h) 'Interexchange telecommunications' means telecommunications between a point or points located in one exchange or serving area (as defined herein or as established by a Class I local telephone company as of the date of these regulations) and a point or points located in one or more other such areas or a point outside such an area: *Provided, however*, That telecommunications between or among a point or points within a Class II local telephone company exchange or serving area and either—

"(1) a point or points within another Class II local telephone company exchange or serving area,

"(2) a point or points within the serving area of any IOC, or

"(3) a point or points within an exchange area of a Class I local telephone company, if the Class II local telephone company exchange or serving area(s) and the IOC serving area have been associated with the Class I local telephone company exchange area as of the date of these regulations or thereafter, shall not be interexchange telecommunications: *And provided further*, That, with the approval of the Commission, a Class II local telephone company may associate the serving areas of other IOCs with its exchange or serving areas, and in such cases telecommunications between a point or points within the Class II local telephone company exchange or serving area and a point or points within the associated IOC serving area shall also not be interexchange telecommunications.

"(i) 'Parent company of a Class II local telephone company' and 'parent company' mean the parent company of a Class II local telephone company and its affiliates.

"(j) 'Serving area' means (1) a geographic area, not within an exchange area, in which a Class II local telephone company does not have the facilities and capability identified in section 3(c) of these regulations but in which it provides exchange telecommunications and exchange access services, provided that all Class II local telephone company geographic areas associated with a single Class I local telephone company exchange area as of the date of these regulations, may be combined into a single Class II local telephone company serving area, and (2) a geographic area in which an IOC provides exchange telecommunications and exchange access services.

"(k) 'Telecommunications service group' means that portion of the headquarters service affiliate of a Class II local telephone company the exclusive function of which is to provide administrative, network, engineering, marketing, service, financial and other support to a Class II local telephone company.

"(l) 'Transmission facilities' means equipment (including without limitation cable, microwave, satellite, and fiberoptics) that transmits information by electromagnetic means or which directly support such transmission.

"PART B—REGULATIONS CONCERNING CLASS I LOCAL TELEPHONE COMPANIES

"SEC. 4. EQUAL ACCESS.

"(a) Each Class I local telephone company shall provide to all interexchange carriers and information service providers exchange access, information access, and exchange services for such access on an unbundled, tariffed basis, that is equal in type, quality, and price to that provided to dominant interexchange carriers and their affiliates.

"(b) Each Class I local telephone company shall take the following actions to ensure such equal access:

"(1) On and after September 1, 1986, each end office of each Class I local telephone company shall offer such equal access, upon bona fide request. Nothing in these regulations shall be construed to permit a Class I local telephone company to refuse to provide to any interexchange carrier or information service provider, upon bona fide request, exchange or information access superior or inferior in type or quality to that provided for a dominant interexchange carrier's interexchange services or information services at charges reflecting the reduced or increased cost of such access.

"(2)(i) Notwithstanding subsection (b)(1), in those instances in which a Class I local telephone company is providing exchange access for Message Telecommunications Service on the date of these regulations through access codes that do not permit the designation of more than one interexchange carrier, then, in accordance with subsection (b)(1), exchange access for additional carriers shall be provided through access codes containing the minimum number of digits necessary at the time access is sought to permit nationwide multiple carrier designation for the number of interexchange carriers reasonably expected to require such designation in the immediate future.

"(ii) Each Class I local telephone company shall, in accordance with subsection (b)(1), offer as a tariffed service exchange access that permits each subscriber automatically to route, without the use of access codes, all the subscriber's interexchange communications to the interexchange carrier of the customer's designation.

"(iii) At such time as the national numbering area (area code) plan is revised to require the use of additional digits, each Class I local telephone company shall provide exchange access to every interexchange carrier, including any dominant interexchange carrier, through a uniform number of digits.

"(3) Notwithstanding subsections (b)(1) and (b)(2), with respect to access provided through an end office employing switches technologically antecedent to electronic, stored program control switches or those offices served by switches that characteristically serve fewer than ten thousand (10,000) access lines, a Class I local telephone company may not be required to provide equal access through a switch if, upon complaint being made to the Commission, the Class I local telephone company carries the burden of showing that for particular categories of services, such access is not physically feasible except at costs that clearly outweigh potential benefits to users of telecommunications services. Any such denial of access under the preceding sentence shall be for the minimum divergence in access necessary, and for the minimum time necessary, to achieve such feasibility.

"(c) Each Class I local telephone company shall take the following additional actions:

"(1) Each Class I local telephone company shall file with the Commission tariffs for the provision of exchange access, including the provision by each Class I local telephone company of exchange access for any dominant interexchange carrier's interexchange telecommunications. Such tariffs shall provide unbundled schedules of charges for exchange access and shall not discriminate against any carrier or other customer.

"(2) Each tariff for exchange access shall be filed on an unbundled basis specifying each type of service, element by element, and no tariff shall require an interexchange carrier to pay for types of exchange access that it does not utilize. The charges for each type of exchange access shall be cost justified and any differences in charges to carriers shall be cost justified on the basis of differences in services provided.

"(3) Except as otherwise authorized by the Commission prior to the date of these regulations, and notwithstanding the requirements of subsection (c)(2), from the date of these regulations until September 1, 1991, the charges for delivery or receipt of traffic of the same type between end offices and facilities of interexchange carriers within an exchange area, or within reasonable subzones of an exchange area, shall be equal, per unit of traffic delivered, or received, for all interexchange carriers: *Provided, however,* That the facilities of any interexchange carrier within five miles of any dominant interexchange carrier's class 4 switch shall, with respect to end offices served by such class 4 switch, be considered to be in the same subzone as such class 4 switch.

"(4) Each Class I local telephone company offering exchange access as part of a joint or through service shall offer to make exchange access available to all interexchange carriers on the same terms and conditions, and at the same charges, as are provided as part of a joint or through service, and no payment or consideration of any kind shall be retained by a Class I local telephone company for the provision of exchange access under such joint or through service other than through tariffs filed pursuant to this subsection (c).

"(d)(1) Nothing in these regulations shall be construed to require a Class I local telephone company to allow joint ownership or use of its switches, or to require a Class I local telephone company to allow co-location in its building of the equipment of other carriers. When a Class I local telephone company uses facilities that (A) are employed to provide exchange telecommunications or exchange access or both, and (B) also are used for the transmission or switching of interexchange telecommunications, then the costs of such latter use shall be allocated to the interexchange use and shall be excluded from the costs underlying the determination of charges for either of the former uses.

"(e) Nothing in these regulations shall either require a Class I local telephone company to bill customers for the interexchange services of any interexchange carrier or preclude a Class I local telephone company from billing its customers for the interexchange services of any interexchange carrier it designates: *Provided, however,* That when a Class I local telephone company does provide billing services to an interexchange carrier, such Class I local telephone company may not discontinue local exchange service to any customer because of nonpayment of interexchange charges unless it offers to provide billing services to all interexchange carriers; *Provided further,* That such Class I local telephone company's cost of any such billing shall be included in its tariffed access charges to such interexchange carrier: *And provided further,* That if a Class I local telephone company provides such billing services to a dominant interexchange carrier pursuant to this subsection, it shall include upon the portion of the bill devoted to interexchange services the following legend:

> "This portion of your bill is provided as a service to [name of dominant interexchange carrier]. There is no connection between this company and [name of dominant interexchange carrier]. You may choose another company for your long distance telephone calls while still receiving your local telephone service from this company.

"(f) Whenever, as permitted by these regulations, a Class I local telephone company fails to offer exchange access to an interexchange carrier that is equal in type and quality to that provided for the interexchange traffic of any dominant interexchange carrier, nothing in these regulations shall prohibit such Class I local telephone company from collecting reduced charges for such less-than-equal exchange access to reflect the lesser value of such exchange access to the interexchange carrier and its customers compared to the exchange access provided to any dominant interexchange carrier: *Provided, however,* That whenever, as permitted by these regulations, a Class I local telephone company fails to offer exchange access to an interexchange carrier that is equal in type and quality to that provided for the interexchange traffic of any dominant interexchange carrier, the tariffs filed for such less-than-equal access shall reflect the lesser cost, if any, of such access as compared to the exchange access provided to such dominant interexchange carrier.

"SEC. 5. NONDISCRIMINATION.

"No Class I local telephone company shall discriminate between dominant interexchange carriers and their affiliates and their products and services, and other persons and their products and services in the: (1) procurement of products and services; (2) establishment and dissemination of technical information and procurement and interconnection standards; (3) interconnection and use of the Class I local telephone company's telecommunications service and facilities or in the charges for each element of service; and (4) provision of new services and the planning for and implementation of the construction or modification of facilities, used to provide exchange access and information access.

"SEC. 6. LINE-OF-BUSINESS RESTRICTIONS.

"(a) No Class I local telephone company shall, directly or through any affiliated enterprise:

"(1) provide interexchange telecommunications services or information services;

"(2) manufacture or provide telecommunications products or customer premises equipment (except for provision of customer premises equipment for emergency services); or

"(3) provide any other product or service, except exchange telecommunications and exchange access service, that is not a natural monopoly regulated by tariff.

"(b) The restrictions imposed upon Class I local telephone companies by subsection (a) shall be removed by the Commission upon a showing by a petitioning Class I local telephone company, that there is no substantial possibility that the petitioning Class I local telephone company could use its monopoly power to impede competition in the market it seeks to enter: *Provided, however,* That insofar as any Class I local telephone company is, as of the date of these regulations, authorized to engage in activity otherwise prohibited by subsection (a), by virtue of a line-of-business waiver granted by the district court in *United States* v. *Western Electric Co.*, No. 82-0192 (D.D.C.), pursuant to section VIII(C) of the Modified Final Judgment in that case, such Class I local telephone company may continue to engage in such activity under the terms and conditions of such waiver.

"(c) Notwithstanding the provisions of subsection (a)(2), each Class I local telephone company shall be permitted to provide, but not manufacture, customer premises equipment.

"(d) Nothing in these regulations shall be deemed to prohibit a Class I local telephone company from producing, publishing, or distributing printed directories that contain advertisements and that list general product and business categories, the service or product providers under these categories, and their names, telephone numbers, and addresses.

"SEC. 7. MISCELLANEOUS PROVISIONS CONCERNING CLASS I LOCAL TELEPHONE COMPANIES.

"(a) Except as otherwise authorized by the Commission prior to the date of these regulations, there shall be no joint ownership of facilities, but appropriate provision may be made for sharing, through leasing or otherwise, of multifunction facilities so long as the separate portion of each Class I local telephone company is ensured control over the exchange telecommunications and exchange access functions.

"(b) Class I local telephone companies may collectively support and share the costs of a centralized organization for the provision of engineering, administrative and other services that can most efficiently be provided on a centralized basis. Class I local telephone companies shall collectively provide, through a centralized organization, a single point of contact for coordination of Class I local telephone companies to meet the requirements of national security and emergency preparedness.

"SEC. 8. PROVISIONS CONCERNING RELATIONSHIPS BETWEEN DOMINANT INTEREXCHANGE CARRIERS AND CLASS I LOCAL TELEPHONE COMPANIES.

"(a) No dominant interexchange carrier shall acquire the stock or assets of any Class I local telephone company.

"(b) Until September 1, 1987, any dominant interexchange carrier or its affiliates shall, upon order of any Class I local telephone company, provide on a priority basis all research, development, manufacturing, and other support services to enable such Class I local telephone company to fulfill the requirements set forth in sections 4 through 7 of these regulations. No dominant interexchange carrier or its affiliates shall take any action that interferes with the Class I local telephone companies' requirements of nondiscrimination, as established by section 5 of these regulations.

"(c)(1) No dominant interexchange carrier shall engage in electronic publishing over its own transmission facilities: *Provided, however,* that nothing in these regulations shall preclude a dominant interexchange carrier from offering electronic directory services that list general product and business categories, the service or product providers under these categories, and their names, telephone numbers, and addresses; or from providing the time, weather, and such other audio services as were offered as of August 24, 1982, to the geographic areas of the country receiving those services as of that date.

"(2) Upon application of a dominant interexchange carrier to the Commission, subsection (c)(1) shall cease to have any force or effect after August 24, 1989, unless the Commission finds that the public interest clearly requires its extension.

"PART C—REGULATIONS CONCERNING CLASS II LOCAL TELEPHONE COMPANIES

"SEC. 9. SEPARATION BETWEEN CLASS II LOCAL TELEPHONE COMPANIES AND AFFILIATED INTEREXCHANGE CARRIERS.

"(a) Except as otherwise authorized by the Commission prior to the date of these regulations, the parent company of a Class II local telephone company shall maintain total separation between itself and any affiliated interexchange carrier, as follows:

"(1) no Class II local telephone company shall directly or indirectly transfer to or obtain from any affiliated interexchange carrier any assets, operations, or line of business, except as provided in subsections (d) and (e) of this section;

"(2) no parent company of any Class II local telephone company shall, under any circumstances, maintain for any affiliated interexchange carrier and any Class II local telephone company (A) common directors, officers, employees (other than the Chief Executive Officer and President of the parent company of a Class II local telephone company), (B) common facilities or assets, or (C) common books of accounts, costs, or expenditures;

"(3) in no event shall a parent company of a Class II local telephone company directly or indirectly provide to, or utilize for the benefit of, any affiliated interexchange carrier any proprietary Class II local telephone company telecommunications information, including but not limited to nonpublic Class II local telephone company customer information or nonpublic network engineering information;

"(4) neither a Class II local telephone company, nor its telecommunications service group (nor such group's successors), shall directly or indirectly provide any administrative, engineering, research and development, or similar services to any affiliated interexchange carrier, nor shall such affiliated interexchange carrier directly or indirectly provide any such services to any Class II local telephone company or such telecommunications service group (or its successors);

"(5) all financing of any affiliated interexchange carrier shall be provided directly by the parent company of the Class II local telephone company with which such interexchange carrier is affiliated, any financing affiliate wholly owned by such parent company, or by unaffiliated sources;

"(6) Class II local telephone companies and any affiliated interexchange carrier shall not jointly provide telecommunications or information services or jointly own the assets used to provide such services; and

"(7) an affiliated interexchange carrier shall (A) obtain all services, information, and products from other affiliates of the parent of a Class II local telephone company (other than Class II local telephone companies, or the telecommunications services group or its successors) only pursuant to contracts, and on terms and conditions no more favorable than such services, information, and products are offered to Class II local telephone companies and (B) bear the fully allocated cost of any services, information, and products obtained from any such affiliate that are not offered by that affiliate to Class II local telephone companies.

"(b) No officer or employee of a Class II local telephone company nor of a parent company of such Class II local telephone company who has direct or indirect managerial or operational authority over a Class II local telephone company shall also have any such authority with respect to an affiliated interexchange carrier: *Provided, however,* That this requirement shall not apply to the Chief Executive Officer and the President of any parent company of such Class II local telephone company.

"(c) An interexchange carrier affiliated with a Class II local telephone company may not be identified with, nor may its services be marketed or identified in connection with, any Class II local telephone company or the services offered by any Class II local telephone company, except that a Class II local telephone company may inform its subscribers in a nondiscriminatory manner of the services offered by interexchange carriers. Nothing contained herein shall prevent an affiliated interexchange carrier and a Class II local telephone company from each separately being identified with the parent company of such Class II local telephone company.

"(d) Nothing in subsection (a) or (b) above shall prohibit a parent company of a Class II local telephone company from:

"(1) transferring to any affiliated interexchange carrier the assets, stock, operations, or telecommunications or information services of—

"(A) any company that was affiliated with the parent company of a Class II local telephone company on January 1, 1985, and that on that date was an authorized domestic satellite carrier;

"(B) any company that was affiliated with the parent company of a Class II local telephone company on January 1, 1985, and that on that date provided packet switching services as a value-added network carrier;

"(C) any affiliate of the parent company of a Class II local telephone company that provides only interexchange telecommunications or information services, customer premises equipment (but not the manufacture thereof or research and development therefor), or unregulated exchange telecommunications or information services;

"(D) any affiliate of the parent company of a Class II local telephone company not providing goods or services to a Class II local telephone company; or

"(E) any other affiliate of the parent company of a Class II local telephone company, subject to the approval of the Commission (except for any domestic interexchange operations or facilities of any Class II local telephone company serving the State of Hawaii, which operations or facilities shall not be transferred pursuant to this subsection (d)(1)(E)); or

"(2) consolidating in a newly created affiliate the assets, stock, operations, or services of any affiliated interexchange carrier and—

"(A) any company that was affiliated with the parent company of a Class II local telephone company on January 1, 1985, and that on that date was an authorized domestic satellite carrier;

"(B) any company that was affiliated with the parent company of a Class II local telephone company on January 1, 1985, and that on that date provided packet switching services as a value-added network carrier;

"(C) any affiliate of the parent company of a Class II local telephone company that provides only interexchange telecommunications or information services, customer premises equipment (but not the manufacture thereof or research and development therefore) or unregulated exchange telecommunications or information services;

"(D) any affiliate of the parent company of a Class II local telephone company not providing goods or services to a Class II local telephone company; or

"(E) any other affiliate of the parent company of a Class II local telephone company, subject to the approval of the Commission.

"(e) Any assets, stock, operations, or services of any affiliate of the parent company of a Class II local telephone company transferred or consolidated pursuant to subsection (d)(1) or (d)(2) above shall not include any such assets, stock, operations, or services that were at any time owned, operated, conducted, or offered by such Class II local telephone company as a regulated exchange or exchange access service.

"(f) Nothing in subsection (d) shall prohibit a parent company of a Class II local telephone company from transferring any unregulated exchange telecommunications services or customer premises equipment from such Class II local telephone company.

"(g) A parent company of a Class II local telephone company shall submit an annual written report to the Commission, accompanied by an affidavit of its Chief Executive Officer and of its President, setting out a summary of the transactions described by this section 9 and attesting to such parent company's compliance with these regulations, and shall provide all further information concerning such transactions as may be requested by the Commission.

"SEC. 10. EQUAL ACCESS.

"(a) Each Class II local telephone company shall provide to all interexchange carriers and information service providers exchange access, information access, and exchange services for such access on an unbundled, tariffed basis, that is equal in type, quality, and price for all interexchange carriers and information service providers, including any information services of a Class II local telephone company.

"(b) Each Class II local telephone company shall take the following actions to ensure such equal access:

"(1) Each Class II local telephone company shall, as promptly as possible, and in no case more than twelve (12) months after receipt of a written request from any interexchange carrier other than a dominant interexchange carrier, offer to all interexchange carriers exchange access on an unbundled, tariffed basis, that is equal in type and quality to that provided for the interexchange telecommunications services of any dominant interexchange carrier, or any IOC, through its end offices that employ switches technologically capable of providing equal exchange access or for which the capability of providing equal exchange access or for which the capability of providing equal exchange access is commercially available to any Class II local telephone company, consistent with the following:

"(A) each Class II local telephone company shall offer equal exchange access through its end offices employing (i) 1-ESS (Electronic Switching System) switches, DMS-100 (Digital Multiplex System) switches, or other electronic stored program control switches, other than those referred to in subsections (ii) and (iii) below, technologically capable of providing equal exchange access, no later than the date of these regulations; (ii) GTD-5 (General Telephone Digital) switches no later than January 1, 1987; and (iii) 1-EAX and 2-EAX (Electronic Automatic Exchange) switches no later than September 1, 1987;

"(B) no later than September 1, 1987, equal exchange access shall be offered through end offices serving at least two-thirds of the exchange access lines provided by all Class II local telephone companies: *Provided*, That (i) a Class II local telephone company need not offer equal exchange access through an end office if, because of changes circumstances that could not reasonably have been foreseen, it is no longer economically feasible to install at that end office a switch technologically capable of providing equal exchange access, and (ii) if any nonaffiliated manufacturer of switches shall fail to provide to the Class II local telephone companies the hardware and software necessary to provide equal exchange access, the two-thirds amount shall be reduced to that extent; and

"(C) no later than December 31, 1990, equal exchange access shall be offered through all end offices serving greater than ten thousand (10,000) exchange access lines: *Provided*, That a Class II local telephone company need not offer equal exchange access through such an end office if, because of changed circumstances that could not reasonably have been foreseen, it is no longer economically feasible to install at that end office a switch technologically capable of providing equal exchange access.

Nothing in these regulations shall be construed to permit a Class II local telephone company to refuse to provide to any interexchange carrier or information service provider, upon bona fide request, exchange or information access superior or inferior in type of quality to that provided for the interexchange services or information services of a dominant interexchange carrier, or any IOC at charges reflecting the reduced or increased cost of such access.

"(2) Notwithstanding subsection (b)(1), a Class II local telephone company shall not have the obligation to provide the facilities and capability for switching interexchange traffic above an end office if the end office is located in such Class II local telephone company's serving area, or to transport such traffic between the end office and a point or points within the serving area designated by an interexchange carrier other than by direct Class II local telephone company transmission facilities. A Class II local telephone company shall use its best efforts to obtain from other carriers those functions that such Class II local telephone company is not obligated to provide under the preceding sentence.

"(3)(A) Notwithstanding subsection (b)(1), in those instances in which a Class II local telephone company is providing exchange access for Message Telecommunications Service as of the date of these regulations through access codes that do not permit the designation of more than one interexchange carrier, then, in accordance with the schedule set out in subsection (b)(1), exchange access for additional carriers shall be provided through access codes containing the minimum number of digits necessary at the time access is sought to permit nationwide, multiple carrier designation for the number of interexchange carriers reasonably expected to require such designation in the immediate future.

"(B) Each Class II local telephone company shall, in accordance with the schedule set out in subsection (b)(1), offer as a tariffed service exchange access that permits each subscriber automatically to route, without the use of access codes, all the subscriber's interexchange communications to the interexchange carrier of the subscriber's designation.

"(C) At such time as the national numbering area (area code) plan is revised to require the use of additional digits (but in no event earlier than the schedule set out in subsection (b)(1)), each Class II local telephone company shall provide exchange access to every interexchange carrier through a uniform number of digits.

"(4) No Class II local telephone company shall be required to provide equal exchange access through an end office employing switches of the technology known generically as step-by-step, if (a) such Class II local telephone company complies with the requirements of subsection (b)(1), and (b) at all end offices employing electromechanical (including step-by-step) switches such Class II local telephone company offers a commercially available trunkside interconnect arrangement to all interexchange carriers, unless such access is not physically possible except at costs that clearly outweigh potential benefits to users of telecommunications services. Each Class II local telephone company shall provide to the Commission such information as it may request concerning any such analysis.

"(c)(1) Each Class II local telephone company shall file tariffs for the provision for exchange access, including the provision by such Class II local telephone company of exchange access for any affiliated interexchange carrier's interexchange telecommunications. Such tariffs shall provide unbundled schedules of charges for exchange access, and shall not discriminate against any carrier or other customer.

"(2) Each tariff for exchange access shall be filed on an unbundled basis specifying each type of service, element by element, and no tariff shall require an interexchange carrier to pay for types of exchange access that it does not utilize. The charges for each type of exchange access shall be cost justified and any differences in charges to carriers shall be cost justified on the basis of differences in services provided.

"(3) Except as otherwise authorized by the Commission prior to the date of these regulations, and notwithstanding the requirements of subsection (c)(2), from the effective date of the tariffs referred to in subsection (c)(1) until September 1, 1991, the charges for delivery or receipt of traffic on the same type between end offices and facilities of interexchange carriers within an exchange area, or within reasonable subzones of an exchange area, shall be equal, per unit of traffic delivered or received, for all interexchange carriers: *Provided, however,* That the facilities of any interexchange carrier within five (5) miles of a Class II local telephone company switch performing a class 4 function shall, with respect to end offices served by such switch, be considered to be in the same subzone as such switch.

"(4) Each Class II local telephone company (and affiliate thereof) offering exchange access as part of a joint or through service shall offer to make exchange access available to all interexchange carriers on the same terms and conditions, and at the same charges, as are provided as part of a joint or through service, and no payment or consideration of any kind shall be retained by a Class II local telephone company for the provision of exchange access under such joint or through service other than through tariffs filed pursuant to subsection (c)(1).

"(d)(1) Subject to the provisions of sections 11 and 12 of these regulations, these regulations shall not require a Class II local telephone company to allow joint ownership or use of its switches, or to require a Class II local telephone company to allow co-location in its building of the equipment of other carriers. When a Class II local telephone company uses facilities that (A) are employed to provide exchange telecommunications or exchange access or both, and (B) are also used for the transmission or switching of interexchange telecommunications, then the costs of such latter use shall be allocated to the interexchange use and shall be excluded from the costs underlying the determination of charges for either of the former uses.

"(2) Nothing in these regulations shall either require a Class II local telephone company to bill customers for the interexchange services of any interexchange carrier or preclude a Class II local telephone company from billing its customers for the interexchange services of any interexchange carrier it designates, provided that when a Class II local telephone company does provide billing services to an interexchange carrier, such Class II local telephone company may not discontinue local exchange service to any customer because of nonpayment of interexchange charges unless it offers to provide billing services to all interexchange carriers. Such Class II local telephone company's cost of any such billing shall be included in its tariffed access charges to such interexchange carrier. If a Class II local telephone company provides billing services to any affiliated interexchange carrier, it shall include upon the portion of the bill devoted to interexchange services the following legend:

> "This portion of your bill is provided as a service to [name of the affiliated interexchange carrier]. You may choose another company for your long distance telephone calls while still receiving your local telephone service from this company.

"(3) Whenever, as permitted by these regulations, a Class II local telephone company fails to offer exchange access to an interexchange carrier that is equal in type and quality to that provided for the interexchange traffic of any dominant interexchange carrier or IOC, nothing in these regulations shall prohibit such Class II local telephone company from collecting reduced charges for such less-than-equal exchange access to reflect the lesser value of such exchange access to such interexchange carrier and its customers compared to the exchange access provided to any other dominant interexchange carrier or IOC.

"SEC. 11. NONDISCRIMINATION.

"No Class II local telephone company shall discriminate between the interexchange telecommunications services, information services, or customer premises equipment of its parent company (including any information services offered by the Class II local telephone company itself) and the interexchange telecommunications services, information services, or customer premises equipment of other persons in the:

"(a) establishment and dissemination of technical information and interconnection standards;

"(b) interconnection and use of the Class II local telephone company's exchange telecommunications or exchange access services and facilities or in the charges for each element of service; and

"(c) provision of new exchange access and information access services and the planning for and implementation of the construction or modification of facilities used to provide exchange access and information access.

"SEC. 12. LINE-OF-BUSINESS RESTRICTIONS.

"(a)(1) No Class II local telephone company shall provide interexchange telecommunications services or own, individually or jointly with its parent company or any other person, facilities that are used to provide such services: *Provided, however,* That nothing in these regulations shall prohibit a Class II local telephone company serving the State of Alaska or Hawaii from providing telecommunications services between Hawaii and Alaska, respectively, and points outside of the United States, and owning the assets necessary to provide such services, if such Class II local telephone company or its affiliate is providing such services as of the date of these regulations.

"(2) Notwithstanding subsection (a)(1), a Class II local telephone company's capacity for interexchange switching and interexchange transmission in facilities in service on January 1, 1984, or in a Class II local telephone company's construction program as of January 1, 1983, and in service by January 1, 1987, may be leased by such Class II local telephone company to any interexchange carrier (or any successor) with which such Class II local telephone company was, as of January 1, 1983, providing interexchange telecommunications services jointly or on a joint through or concurring tariff basis, for the provision of interexchange telecommunications services by such carrier. Any such leases shall ensure that such Class II local telephone company retains control of sufficient switching and transmission capacity to provide exchange telecommunications and exchange access services in accordance with the requirements of these regulations.

"(3) Nothing in these regulations shall prohibit a Class II local telephone company, in any location in which it has assets subject to subsection (a)(2) for which it has not recovered its capital investment and for which the leases described in subsection (a)(2) are not in effect, from replacing an existing agreement with a Class I local telephone company or dominant interexchange carrier with an agreement with an interexchange carrier (other than an affiliated interexchange carrier) that will permit the recovery of the net book value of such capital investment and the costs thereof, including a return on debt or equity, so long as that agreement terminates when such net book value has been recovered.

"(4) In the event that the arrangements described in subsection (a)(2) and (a)(3) are not in effect, each Class II local telephone company shall make its interexchange routing and transmission capacity provided by assets subject to subsection (a)(2) available to all interexchange carriers on nondiscriminatory terms and conditions, and may expand and modernize (but not replace) such interexchange routing and transmission facilities if it offers to make available such expanded or modernized capacity to all interexchange carriers on nondiscriminatory terms and conditions.

"(5) Nothing in subsection (a)(2), (a)(3), or (a)(4) shall preclude, either explicitly or implicitly, any Class II local telephone company or parent company thereof from pursuing appropriate remedies before regulatory bodies and elsewhere to recover such Class II local telephone company's financial investment in the assets subject to subsection (a)(2).

"(b)(1) No Class II local telephone company shall provide information services or own jointly with its parent company or any other person facilities that are used to provide such services.

"(2) Notwithstanding subsection (b)(1), a Class II local telephone company may provide information services through a separate entity (either an incorporated subsidiary or an unincorporated division having separate books of account and reporting directly to the chief operating officer of such Class II local telephone company) that obtains from such Class II local telephone company telecommunications services, telecommunications facilities (including the right to co-locate its equipment in buildings used to provide exchange telecommunications), and billing services, only to the extent that such services and facilities are made available to other persons pursuant to tariffed and unbundled schedules of charges and in accordance with the requirements of section 11 of these regulations, and obtains administrative and other services (including the use of Class II local telephone company maintenance and installation personnel) from such Class II local telephone company (A) only on the same terms that such services are obtained by nonaffiliated persons, and (B) in other cases only at fully allocated costs. No such separate entity shall to any extent own or control facilities used to provide regulated exchange telecommunications or exchange access services, have personnel who simultaneously market both regulated exchange telecommunications or exchange access services and information services, or directly or indirectly obtain proprietary Class II local telephone company marketing, customer, or network engineering information.

"(3) The limitations of subsection (b)(1) and (b)(2) shall expire:

"(A) upon a showing before the Commission by a Class II local telephone company that there is no substantial possibility that it could use its monopoly power to impede competition in the information services market it seeks to enter; or

"(B) whenever and to the extent that the Commission relieves a Class I local telephone company of the provisions of section 6 of these regulations, either (i) throughout a State, in which case the limitations of subsection (b)(1) and (b)(2) shall not apply to the information services of a Class II local telephone company within such State, or (ii) in any Class I local telephone company exchange area, in which case the limitations of subsection (b)(1) and (b)(2) shall not apply to the information services of a Class I local telephone company within any Class II local telephone company exchange or serving area, if telecommunications between such Class II local telephone company exchange or serving area and such Class I local telephone company exchange area are not interexchange telecommunications.

"(c) Insofar as any Class II local telephone company is, as of the date of these regulations, authorized to engage in activity otherwise prohibited by subsection (a) or (b), by virtue of section V(D)(3)(b) of the final judgment in *United*

States v. *GTE Corporation*, No. 83-1298 (D.D.C.), such Class II local telephone company may continue to engage in such activity under the terms and conditions upon which it could lawfully engage in such conduct as of the date of these regulations.

"SEC. 13. MISCELLANEOUS PROVISIONS CONCERNING CLASS II LOCAL TELEPHONE COMPANIES AND THEIR AFFILIATES.

"(a) Until December 21, 1994, except with the approval of the Commission, no parent company of a Class II local telephone company shall acquire a direct or indirect equity interest in (or the equivalent thereto), whether or not controlling, or the assets of, any carrier, other than an affiliated interexchange carrier (as defined by these regulations), providing interexchange telecommunications services in the United States.

"(b) Subsection (a) shall not prohibit the insurance subsidiaries of the parent company of a Class II local telephone company, if any, and the pension and profit-sharing trusts of such a parent company and its subsidiaries, from acquiring, or holding for investment purposes, interests in the assets, stock, or other beneficial interests in any organization to the extent permitted by the laws governing investments of insurance companies and pension and profit-sharing trusts.

"(c) Subsection (a) shall not prohibit the acquisition by the parent company of a Class II local telephone company, by purchase or other form of transfer, of (1) assets used to provide exchange telecommunications which shall only incidentally be used to provide interexchange services, or (2) an interexchange carrier that obtains less than five (5) percent of its gross telecommunications revenues from telecommunications services between points within the United States.".

SEC. 202. REMEDY FOR VIOLATIONS OF COMMISSION REGULATIONS.

If it appears to the Commission at any time that any person subject to any provision of any regulation promulgated pursuant to section 201 has failed to comply with such provision, or that any person has violated any provision of any such regulation, the Commission may, after notice and opportunity for hearing, direct such person to comply with, or to cease and desist from violating, any provision of any such regulation, and may order or impose such further remedy provided in title V of the Communications Act of 1934, (subchapter V of chapter 5 of title 47 of the United States Code), as the Commission may deem appropriate.

SEC. 203. MODIFICATION OF, EXEMPTION FROM, AND WAIVER OF COMMISSION REGULATIONS.

(a) The Commission may modify or rescind any provision of any regulation promulgated pursuant to section 201, and in connection with such modification or rescission may expressly permit any action or course of conduct theretofore prohibited by such provision, if, after notice and an opportunity for hearing, the Commission determines that such modification or rescission would be in the public interest.

(b) The Commission may by rules and regulations or, upon application of any interested person or on its own motion, by order, after notice and opportunity for hearing, in whole or in part exempt any person or class of persons from the application of any provision of any regulation promulgated pursuant to section 201, or waive the application of any such provision to any action or course of conduct proposed to be taken or engaged in by any person or class of persons, if the Commission determines that such exemption or waiver would be in the public interest.

SEC. 204. EFFECT OF COMMISSION REGULATIONS.

Any action or course of conduct expressly permitted by any provision of any regulation promulgated pursuant to section 201, or by any order issued by the Commission pursuant to such regulations, or by any action of the Commission pursuant to section 203, shall not, with respect to the person or class of persons expressly permitted to take such action or engage in such conduct, be deemed to violate any provision of any final judgment or decree entered before the date of this

Act by any court of the United States in any case arising under the antitrust laws of the United States.

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STATEMENT OF HON. ROBERT DOLE, U.S. SENATOR FROM KANSAS

Senator Dole. Thank you. I did not know a little bill such as this would draw such a crowd. But I know this is a very exciting committee and a lot of people are just here to see what is happening. That is why I am here, to see what is happening.

Let me say first of all, I would like to summarize my statement and include it all in the record.

I do appreciate very much, Mr. Chairman, your scheduling these hearings. I know you have been, as many of us have, giving full time to tax reform, and that is still not behind us. But I think we are in a stage now where members of the Finance Committee who are also involved in other matters can at least take a look at the other areas.

And I appreciate the fact that hearings are being held on this bill, which I introduced in late June. And I still believe that, with some help and some interest, we can complete action on this bill this year. I am not certain how long we will be here, but I am hopeful that we will be gone by October 3rd, and I think most Americans agree that the sooner we leave the better.

But we are not faced with a question of whether AT&T and the Bell operating companies ought to be reunited. The consent decree settling the antitrust litigation was made final more than four years ago, and divestiture occurred nearly three years ago.

It was without a doubt the most massive restructuring of an industry that I have ever witnessed. There have been stops and starts, extraordinary remedies and extraordinary procedures utilized along the way. But it seems to me we must keep in mind that the fundamental decisions about the divestiture of AT&T are behind us.

It is now time to review the way in which our telecommunications industry has been and is being regulated, and decide how best to regulate this industry in the future so that this country maintains the best telecommunications system in the world.

The modified final judgment required AT&T to divest the Bell operating companies, and it specified what businesses the BOC's would engage in. The BOC's were specifically prohibited from entering into the interexchange equipment manufacturing and information service business. A waiver procedure was established which allowed entry into certain lines of business if the BOC's could show that there was no substantial possibility that it could use its monopoly power to impede competition in the market it sought to enter.

Since January of 1984, 110 waiver requests have been filed. Each waiver request must be carefully scrutinized by the Justice Department, which has come to view the process as burdensome, time-consuming, and inefficient. Simply put, this process has caused the Justice Department, a law enforcement agency, to utilize inordinate resources performing regulatory functions.

It has given Judge Greene the status as a super-regulator of the telecommunications industry, a post to which he was neither elected nor appointed. Indeed, Congress never intended for the antitrust enforcement machinery to be used for the long term day to day regulation of industries.

At present, our Federal system of telecommunications regulation can best be described as a three-ring circus, as companies often have to satisfy the Justice Department, the FCC, and now a Federal court. This is hardly the perfect environment in which to foster a competitive and technologically innovative industry.

That is why, after considerable reflection, study, and consultation with a number of people in and out of the industry, that I consented to introduce S. 2565. Having recognized that much of Federal telecommunications policymaking has fallen into the lap of Judge Greene, we must also recognize that one of these days Judge Greene will retire from the bench.

At that point we will appoint another Federal judge to the bench and, oh, by the way, have that person become responsible for regulating telecommunications policy. Clearly not.

The question is not whether we will transfer the responsibility of Federal telecommunications policymaking away from the Federal judiciary. The question is when and to where, and S. 2565 simply consolidates in the FCC all Federal telecommunications policy, including the AT&T and GTE consent decrees which have governed the telephone and telecommunications industries since 1982.

The bill would require the FCC to issue regulations incorporating and enforcing the provisions of the consent decrees.

And I have noted that certain witnesses have been asked to talk about the merits of allowing the BOC's to participate in the field of manufacturing equipment, interexchange service, and the like. There will undoubtedly be an interesting and spirited discussion.

But I would remind the committee that S. 2565 is a simple procedural bill which does not address the substantive provisions of the consent decree. Someone asked why the FCC, and I have outlined in some extent why I believe the FCC should play the proper role. Regulatory jurisdiction over the telecommunications industry should be consolidated at the FCC for several important reasons.

First, as an institutional matter, Congress will play a major role in developing the policy in an industry as significant as telecommunications. That is not to say that Congress necessarily should decide whether and when each of the lines of business restrictions should be lifted. That would be unworkable. It is also unnecessary.

If the FCC announces a policy change that is ill-conceived, Congress can change the policy. Perhaps most importantly, telecommunications policymakers ought to be guided by the public interest standard, not by the narrow antitrust standard which is currently employed. At present the court, unlike the FCC, simply cannot legitimately take into account important considerations such as our trade balance, national security, the need of residential small businesses and rural telephone users, and universal service, in administering its regulations.

So I would conclude that I think that we are moving in the right direction in transferring authority to the FCC. And finally, let me just briefly address opposition to the bill, because I have noted there is some opposition. Now, if this is a simple, which I perceived it to be and I still think it is, a simple transfer from a judge to an appropriate regulatory agency, then why should there be opposition and why does a large portion of the industry oppose it?

I think the committee members will certainly have an opportunity to explore that in depth and can probably come up with some areas of compromise or some areas that would at least clarify the opposition, whatever the committee wishes to do.

It is clear to me that companies who oppose this bill do so for reasons unrelated to the question of whether the FCC is the more appropriate forum for the Federal telecommunications policymaking than is a Federal district judge.

I do not think anybody would argue that we ought to let a Federal judge decide all the regulatory questions. And frankly, some segments of the industry think they got a pretty good deal from the judge and they are unwilling to risk losing that protection.

But all of that assumes that if this bill passes the FCC will immediately take steps to undo the provisions of the decree. Now, if I felt that the FCC had prejudged the issues it may be asked to rule on in a future line of business waiver proceeding, I would agree that it would be inappropriate for jurisdiction to be transferred to the Commission, at least as it is currently constituted.

But I do not believe that to be the case. In addition, I feel there are important procedural safeguards which will guarantee, through review of the consent degree provisions by the FCC under my bill, the notice, comment, and review provisions of the Administrative Procedures Act and the Communications Act of 1934 must be followed.

So even assuming a worst case scenario, that the FCC wanted to gut the consent decrees immediately, which some opponents have claimed, it cannot be argued that this bill gives them that unfettered discretion to do so. But more importantly, Judge Greene provided that the Justice Department submit a report every three years with a recommendation on which, if any, of the restrictions should be lifted.

The first of these will be submitted later this year by Peter Huber, a consultant appointed by the Department. In my view, there is no reason why the report can't guide the FCC just as we would expect it to guide the court if the legislation is not enacted.

So I will just say, as I started, I think this is a very simple bill. That was by design. There was not any effort to settle all the problems. I know the publishers have some problems. We worked with them trying to work out their problems—unable to reach an agreement.

But again, I would conclude as I started, by commending the committee for holding these hearings and to indicate my willingness to work with the chairman and other members on the committee who have supporting and opposing views to see if we can reconcile our differences before the end of the year.

The CHAIRMAN. Thank you, Senator Dole.

[The statement follows:]

STATEMENT OF HON. BOB DOLE, U.S. SENATOR FROM KANSAS

Mr. DOLE. Mr. Chairman, first let me say that I am appreciative of your efforts in scheduling hearings on this important subject. I know the chairman has had a full agenda this summer with the tax bill, products liability, trade legislation, etc., and I appreciate the fact that hearings are being held on this bill, which I introduced in late June, in a timely manner.

We are not faced with the question of whether AT&T and the Bell operating companies ought to be reunified. The consent decree settling the antitrust litigation was made final more than four years ago and divestiture occurred nearly three years ago. It was without a doubt the most massive restructuring of an industry that I have witnessed. There have been stops and starts, extraordinary remedies and extraordinary procedures utilized along the way. But it seems to me we must keep in mind that the fundamental decisions about the divestiture of AT&T are behind us.

It is now time to review the way in which our telecommunications industry has been and is being regulated, and to decide how to best regulate this industry in the future so that this country maintains the best telecommunications system in the world.

CURRENT REGULATORY ENVIRONMENT

The modified final judgment [MFJ] required AT&T to divest the Bell Operating Companies [BOC's] and it specified what business the BOC's would engage in. The BOC's were specifically prohibited from entering into the interexchange, equipment manufacturing and information services businesses. A waiver procedure was established which allowed entry into certain new lines of business if the BOC's could show that there was no substantial possibility that it could use its monopoly power to impede competition in the market it sought to enter.

Since January of 1984, 110 waiver requests have been filed. Each waiver request must be carefully scrutinized by the Justice Department, which has come to view the process as burdensome, time consuming, and inefficient. Simply put, this process has caused the Justice Department, a law enforcement agency, to utilize inordinate resources performing regulatory functions. It has given Judge Greene the status as superregulator of the telecommunications industry, a post to which he was neither elected or appointed. Indeed, Congress never intended for the Antitrust Enforcement Machinery be used for the long term, day-to-day regulation of industries.

At present, our system of Federal telecommunications regulation can best be described as a three ring circus as companies often have to satisfy the Justice Department, the FCC, and a Federal court. That is hardly the perfect environment in which to foster a competitive and technologically innovative industry.

S. 2565—A MORE COHERENT REGULATORY ENVIRONMENT

Having recognized that much of Federal telecommunications policy-making has fallen into the lap of Judge Greene, we must also recognize that one of these days Judge Greene will retire from the bench. At that point, do we appoint another Federal Judge to the bench—and oh, by the way, have that person become responsible for regulating telecommunications policy. Clearly not. The question is not whether we will transfer the responsibility of Federal telecommunications policy-making away from the Federal judiciary. The question is when and to where.

S. 2565 simply consolidates in the FCC all Federal telecommunications policy, including the AT&T and GTE consent decrees, which have governed the telephone and telecommunications industries since 1982. The bill would require the FCC to issue regulations incorporating and enforcing the provisions of the consent decrees.

I have noted that certain witnesses have been asked to talk about the merits of allowing the BOC's to participate in the field of equipment manufacturing, interexchange service, and the like. That will undoubtedly be an interesting and spirited discussion, but I would remind the committee that S. 2565 is a simple procedural bill which does not address the substantive provisions of the consent decree.

WHY THE FCC?

Regulatory jurisdiction over the telecommunications industry should be consolidated at the FCC for several important reasons.

First, as an institutional matter, Congress should play a major role in developing policy in an industry as significant as telecommunications. That is not to say that Congress should necessarily decide whether or when each of the lines of business restriction should be lifted. That would be unworkable. It is also unnecessary: It is precisely for situations such as this that Congress creates expert agencies. The FCC is the regulatory agency created in 1934 for the purpose of providing expertise in the communications area. In my view, it is hard to resist the logic of letting them assume the role they were created to fill, with Congress playing an active oversight role.

If the FCC announces a policy change that is ill-conceived, Congress can change the policy. We can enact legislation, we can effect subtle changes through the appointment process. . .there are a variety of options available to us to ensure that the FCC stays in line. When a Federal court makes a ruling that is way off the mark, there is not much Congress can do. As the majority leader, I feel it my duty to represent the institutional interests of the Senate. This is a textbook case.

Secondly, regulatory proceedings of the FCC offer a far greater opportunity for interested citizens who are not parties to the direct proceedings to participate than do the judicial regulatory proceedings administered by Judge Greene.

Perhaps most importantly, telecommunications policymakers ought to be guided by the public interest standard, not the narrower antitrust standard which is currently employed. At present the court, unlike the FCC, simply cannot legitimately take into account important considerations such as our trade balance, national security, the needs of residential small business and rural telephone users, and universal service in administering its regulations.

This is frankly how I became interested in this subject: Last August I headed a congressional delegation to the Far East. One of our major objectives was to address the growing trade imbalance with Japan. I learned that our world telecommunications equipment trade account had shown a surplus of $203 million in 1981, and that it was headed towards a deficit of $1.8 billion in 1985. The U.S.-Japan trade picture had deteriorated from a $323 million deficit in 1981 to a $1.2 billion deficit in 1985.

We've become a net importer of telecommunications equipment over the past few years for a variety of reasons—the dollar, the quality of foreign products, the lack of access to foreign markets among them. But we can't ignore the fact that the consent decrees have taken some of our most efficient companies entirely out of the world telecommunications equipment market.

I am not today advocating that the manufacturing provisions be lifted. But I do think it is absurd that telecommunications policy is being made without any regard given to trade concerns. By having policy made in the wrong arena and by the wrong standard, we are placing blinders on the policymakers. That situation would be corrected by transferring jurisdiction over telecommunications policy to the FCC.

Not only does the FCC have the requisite subject matter expertise and a broad public interest mandate, they are far better equipped in terms of personnel and resources to regulate the telecommunications industry than is Judge Greene, who must make do with less than a handful of law clerks.

OPPOSITION TO THE BILL

If this is so simple, why does a large portion of the industry oppose it? The committee members will have an opportunity to explore this question, but I would suggest a few obvious answers.

It is clear to me that companies who oppose this bill do so for reasons unrelated to the question of whether the FCC is the more appropriate forum for Federal telecommunications policymaking than is a Federal district judge. Frankly, some segments of the industry think they got a pretty good deal from the judge and they are unwilling to risk losing that protection. But all of that assumes that if this bill passes, the FCC will immediately take steps to undo the provisions of the decree.

If I felt that the FCC had prejudged issues it may be asked to rule on in future line of business waiver proceedings, I would agree that it would be inappropriate for jurisdiction to be transferred to the commission—at least as it is currently constituted. But I don't believe that to be the case.

In addition, I feel there are important procedural safeguards which will guarantee thorough review of the consent decree provisions by the FCC. Under my bill, the notice, comment, and review provisions of the Administrative Procedures Act and the Communications Act of 1934 must be followed. So even assuming a worst case scenario that the FCC wanted to gut the consent decrees immediately, which some opponents have claimed, it can't be argued that this bill give them unfettered discretion to do so.

But more importantly, Judge Greene provided that the Justice Department submit a report every three years with recommendations on which if any of the restrictions should be lifted. The first of these will be submitted later this year by Peter Huber, a consultant appointed by the department. In my view, there is no reason why that report can't guide the FCC just as we would expect it to guide the court if the legislation is not enacted.

SUMMARY

In summary, let me just say that this is a simple bill—and that is by design. I believe Congress should play an oversight role in these matters, with the FCC doing the bulk of the work.

I have in the past considered introducing legislation in this area which would substantively alter certain provisions in the consent decree. I chose not to do so because I was persuaded that reaching a consensus on which consent decree restrictions should be lifted and when would spark a battle of major proportions.

I am as convinced now as ever that my judgment was correct. It will be fruitless in the current environment to attempt to negotiate substantive deals with all of the players in this complex field. The only way Congress can pass legislation in this area is to keep it simple.

I recognize that the chairman and others are inclined to provide safeguards and specific guidance to the FCC in terms of implementing the bill. Some of these may substantially improve the bill, but we can't go too far in that direction or we'll undermine the need for the legislation. This may be a project not unlike the tax bill: It only makes sense to pass it if we agree to not try to satisfy all segments of the industry.

Senator **Pressler**. Thank you, Mr. Chairman.

I have to go to the impeachment hearing. Senator Mathias had breakfast with me this morning. He said if I was not on time I might be impeached. So I will be very brief.

But I might tell Senator Dole before he departs that the August Leader is against your bill.

Senator **Dole**. Is that in South Dakota?

Senator **Pressler**. Yes.

Senator **Dole**. Do they have an early primary?

Senator **Pressler**. Yes.

The **Chairman**. Any questions for Senator Dole?

[No response.]

The **Chairman**. Mr. Leader, thank you very much.

OPENING STATEMENT BY SENATOR PRESSLER

Senator **Pressler**. Mr. Chairman, I would just like to make a brief statement.

First of all, let me say that I believe this is an extremely important issue, and I plan to take a very active role in the debate as we go forward. Unfortunately, my schedule today is such that it is in direct conflict with the impeachment committee meeting, which I am told require mandatory attendance by those Senators who have that duty. So I shall have to leave here shortly, so I shall just summarize my statement and I am going to leave some questions for the record.

I want to emphasize at the outset my keen interest in this issue and indicate to parties on all sides that my personal suggestion box is open. I come to these hearings today with a very open mind, although I do not have any hard and fast preconceived notions as to how this matter should ultimately be resolved.

I do have some serious concerns on both sides of the issue. I have a great many questions for the witnesses today and next week. If the impeachment panel precludes my asking them here, they will be submitted for the record.

Let me touch just briefly on some of my general concerns.

RURAL SERVICE

As is so often the case in the communications area, this is another battle between the big and the bigger. I am very concerned about its possible consequences for rural service, particularly regarding small local coops and the independent telephone companies.

COMPETITION

I am carefully studying the impact this proposal would have on competition. On the one hand, I always like to see more players in the field. I think this would help speed up technological development and help give consumers what they want.

On the other hand, I want to make sure we have a level playing field. I am not certain that now exists.

CONSUMER COSTS

We have heard a great deal about the possibility of seeing the operating committees use their local monopolies to subsidize the new competitive businesses in which they would enter as a result of this legislation. I am not convinced that we can adequately police against that kind of activity and other unfair advantages the local common carrier might have.

JURISDICTION

I seem to get the feeling that most people are convinced that we need a forum change, and most of the debate is centered around how and when we are going to do it, rather than if we are going to do it at all. I would like to explore the latter issue in much greater detail before going forward too much further in the process.

Other than the broadest statements about who ought to be deciding telecommunications policy in this country, I have heard very little substantive debate on the very fundamental point of whether we should be taking this jurisdiction away from the court.

And I think that, let us face it, procedure becomes substance, and we have got to debate the substance.

PROTECTIONISM

Notwithstanding all these concerns, I hold a very strong belief that we do need more competition in this area. It seems to me that a lot of money is being spent by established interests to protect their turf against competition from the Bell operating companies. This seems to be a recurring theme in regulated industries.

When cable TV was first coming on line, the broadcasters tried to keep them out, and I remember that so well in my short lifetime around here. Now that cable—now that the cable industry is established, they are trying to keep the satellite dish industry out.

This issue seems analogous in many ways. Everyone is trying to keep the operating companies out. Those arguing to keep them out spend a lot of time arguing "in the public interest." I think many of the proponents are confusing public with special interests, and believe it is important for us to keep that in perspective as we go forward.

With that, I will conclude by reiterating my interest in this bill. As I mentioned, I will have to leave for the impeachment proceedings shortly, but will leave questions. And let me conclude, Mr. Chairman, by saying that in my 12 years as a member of the House and Senate and working on communications issues, every time something new comes along or there is an area for competition we get these arguments that in the public interest and so forth.

And really, people are trying to protect their own turf. And if the public, the consumers—if there should be more advertising on TV, if that helps a little old lady, that's what we should be interested in, not in preserving something for somebody unless there's a reason for it.

So I hope we get to the substance of this debate. And Mr. Chairman, I submit my questions for the record.

The CHAIRMAN. OK. Thank you, Senator Pressler.

Any more opening statements? Senator Gorton?

OPENING STATEMENT BY SENATOR GORTON

Senator GORTON. I have one, Mr. Chairman. But the chairman himself has not made an opening statement.

The CHAIRMAN. No. Thank you very much. I will put mine in the record. I really don't think people are here to hear my opening statement.

Senator GORTON. Oh, I think you would be surprised, Mr. Chairman.

But in any event, if you wish to put yours in the record, I will make one.

I am of course pleased that you called these hearings. I believe that they give this committee an opportunity to take a new look at our responsibilities as telecommunications policymakers in light of the radical changes in the industry since the divestiture of the local Bell operating companies from AT&T in January 1984.

There is no question that the breakup of the Bell system has been viewed through confused and skeptical eyes by many of our constituents. The simple failure to get a dial tone can lead to a million questions: How much will it cost to fix this telephone? Will someone come to my home? Is the problem in the phone itself or in the wires?

And the main question, of course: Whose fault is this and why won't they fix it for free, like they used to?

In addition to this confusion, other concerns arose as a result of the divestiture. One of the main ones was the effect it would have on local rates.

When the phone company operated as one integrated unit, it was relatively straightforward and easy to develop pricing policies that kept local rates low by keeping the cost of long distance service artificially high.

In order to maintain this type of pricing and prevent local rates from rising dramatically after divestiture, access charges were imposed on interexchange carriers. Steps were also taken to begin transferring some costs to consumers in the form on end user charges, a controversial move that will remain controversial in light of proposals to increase them even further.

Whenever there is such widespread dissatisfaction in the ranks, Congress feels compelled to step in and try to straighten things out, which is as it should be, I suppose. It is important for us to remember, however, that along with the dissatisfaction a great deal of vitality and new competition have resulted from the divestiture.

Much of that vitality has come from the regional holding companies themselves, which are now seeking to expand their lines of business even further. I can appreciate the desire of these companies to venture into new areas. They have proven that they are eager to get out and compete in many arenas.

They are understandably frustrated by the sometimes cumbersome judicial and regulatory processes to which they are subject. Despite this understanding, I must express misgivings about the bill before us today and the haste with which we are considering it.

In my view, this bill raises a legion of questions. On its face, it appears simply to transfer jurisdiction from one forum to another. In reality, however, we all recognize that Judge Greene's perspective about enforcement of the consent decree is far different from that of Chairman Fowler and his fellow Commissioners.

Although he may well take exception to this, it seems plain to me that Chairman Fowler believes that the regional holding companies should be released from the constraints of the decree as soon as possible. Because this bill gives the Commission to make that decision, it is our responsibility as member of this committee to study the possible effects of lifting the consent decree.

Should the local companies be allowed into long distance information services and manufacturing? After years of continued antitrust litigation and strenuous attempts to resolve that litigation short of divestiture, it became clear that the inherent competitive problems of combining a local access bottleneck with competitive access-dependent business has made in necessary to separate those businesses.

Have market conditions and technologies changed so dramatically in the past three years that we should consider reversing that decision? Perhaps so, but perhaps we should give the court the first opportunity to make that decision. Judge Greene recognized that conditions in the industry would change and provided for regular reviews of the modified final judgment to assess whether its provisions should be revised.

The first such assessment will occur early next year, and I think it wise to wait and see what results from that review. I must say, however, that I do not believe that we should permanently or indefinitely vital communications issues in the courts. We are elected to make or to guide such policy.

It does appear to me that after we have studied this issue in some detail the committee will have four alternatives: First, to leave the issue to the courts; second, to make the policy decisions implicit in this bill itself; third, to transfer authority for these policy decisions from the courts to the Federal Communications Commission, as contemplated by S. 2565; or, four, to transfer some of this authority to the Federal Communications Commission with clear guidelines and limitations set by Congress.

I believe this latter course is the one that the chairman has chosen in his proposed amendments to the bill, and my guess would be that this is the course the committee will choose as well.

The issues that we are discussing today go to the very heart of our nation's telecommunications policy, as well as, of course, affecting profoundly telecommunications users, the consumers, our constituents. It is entirely appropriate that this committee start to examine them.

I think it will be difficult, as well as undesirable, for us to give them the attention they deserve before the end of this Congress. But I am eager to work closely with the chairman and the Majority Leader in the future. I look forward to hearing from the witnesses both today and next week.

And I thank you, Mr. Chairman.

The **CHAIRMAN**. Thank you, Senator Gorton.

Senator Riegle.

OPENING STATEMENT BY SENATOR RIEGLE

Senator **RIEGLE**. Mr. Chairman, I just want to make a couple of observations at the outset. I think that the problem with the trade invasion that is under way in this country has now reached a point where the deficit, the trade deficit, this year will probably be $175 billion or higher.

We have become the number one debtor nation, and we are adding to our debtor nation status at the rate of a billion dollars every two and a half days.

And I am very interested in having the witnesses today talk about the international competitive pressures that they see developing in these business areas and the degree to which particularly the operating companies are facing international competition of established sorts and new sorts that we should understand and take into account.

I am very much concerned about the job base in this country, and I think that has to be looked at at the same time we look at issues of clearly whether the public interest is being fully and properly served under the present arrangements, and whether customers' service and quality and price is everything that it can be and we would like to see it be.

But I would just ask the witnesses when they come if they would address particularly the question of international competitive pressure as it's developing in these business areas and shed whatever light they can on that and the possible loss of future economic vitality in this country and U.S. jobs.

Thank you.

The **CHAIRMAN**. Thank you, Senator Riegle.

Senator Gore has a statement for the record.
[The statement follows:]

Opening Statement by Senator Gore

Mr. Chairman, I want to congratulate you for scheduling this important series of hearings. I am disappointed that I cannot be here personally. As a member of the Senate panel hearing opening testimony this morning in the impeachment trial of Judge Claiborne, I must necessarily be away from the hearing.

As you know, I have been actively involved in issues related to telecommunications regulation, and I have numerous questions for the witnesses. With your permission, I will ask the Committee to submit my questions to witnesses, and include for the record my complete statement.

I want to take this opportunity to summarize my view of the regulatory environment facing the telecommunications industry as the Senate considers the Dole bill, my bill, and the Swift-Tauke bill in the House. Each of these measures addresses a critical aspect of the problems facing not only the Bell regional companies and their current and potential competitors, but also those problems facing telephone ratepayers, small, independent rural telephone companies, small businesses, and others vitally concerned about the future of telephone service in this country.

Much of the debate on the question of relaxiing the Modified Final Judgement restrictions on the BOCs has focused on whether or not the Federal Communications Commission is committed to adequate protections for ratepayers and competitors. Chairman Fowler has not done himself or the Commission a service by—through public speeches-advocating rapid, wholesale deregulation of all telecommunications services. Those are not statements that comfort those of us in the Senate who are sympathetic toward the BOC initiatives to enter new competitive fields, but who also want to make certain that BOC entry into these areas will not result in ratepayer cross subsidies and unfair competitive practices.

There is little question in my mind that the FCC should be in the best position of any federal agency to oversee regulatory transition in the telecommunications industry. Aside from its fundamental role in enforcing antitrust laws, the Justice Department has little experience and few resources to do this job, and, I suspect, Judge Greene and the Department will look forward to the day they do not have to review a BOC waiver request.

However, it is entirely reasonable to worry that the FCC has prejudged MFJ issues, and we must be absolutely certain, whether through the Dole-Danforth measure, or my bill, or some other measure, that we insist that the FCC not abandon its responsibility for equity among ratepayers and industry competitors.

I support changes in the MFJ. I believe that telephone customers as well as our entire economy can benefit from BOC activity in certain information services and manufacturing businesses. I believe that BOC entry into manufacturing can have a measurable impact on our trade deficit and, more importantly, in creating jobs here in this country, jobs that are now being exported to offshore manufacturing enterprises.

I also believe that the current MFJ restrictions have unduly limited new information and other enhanced services for telephone customers. Some of these services will probably never be made available unless the BOCs are allowed to do so. In addition, many new services will produce revenues under tarriff to help keep down future local rate increases.

However, BOC competitors have legitimate concerns about allowing the regional companies into their business areas, and we will need to address those concerns if this Committee actually marks up a bill in this session.

First and most importantly, we must insist on prohibitions against BOC subsidizing speculative ventures out of regulated ratepayer revenues. There are some critics of MFJ relaxations that have stated flatly that such protections are impossible. I am not prepared to accept that analysis. The Senate and this Committee are equipped to conduct thorough oversight over FCC activity in this area. But it is a fact that those protections must be in place, and they must be solid.

Next, we must insist that the BOCs not be able to abuse their position as a local monopoly to shut out competition in new services and manufacturing by somehow manipulating their customer base, or using their transmission bottleneck to discriminate against competitors.

These are some of the concerns we will face if we send a bill to the Senate floor this year. If we fail to resolve the ratepayer protection and competitor discrimination issues, we cannot realistically expect the Senate to pass any bill dealing with MFJ jurisdiction or substance.

Mr. Chairman, there are other related issues in this debate. Whether this year or next, the Senate must face another likely proposal to increase customer subscriber line charges. My bill rolls back those unfair, federally-mandated telephone customer access charges. If any telephone legislation moves to a vote in this Committee or on the floor, I will attempt to add such a rollback, or at least a cap, on subscriber line charges.

My bill also places a prohibition on any effort to repeal the current rule of toll rate averaging among all long-distance users of the near-monopoly interstate services. This is an issue of considerable importance to rural telephone customers, and I believe the Senate should reaffirm the policy which prevents unfair discrimination against those who live outside major metropolitan centers. I will work to ensure that any bill moving ahead this year contain such a provision.

There are other telecommunications issues imbedded in the debate over MFJ relaxations, and I believe they deserve considerable discussion in this Committee and by the Senate. I want to work with the Chairman and Senator Hollings, who has devoted so much time to these issues over the years, to ensure that any legislative product of this Committee be fair, balanced, and comprehensive.

Thank you.

The CHAIRMAN. We are happy to have as the next witness Senator Wilson.

STATEMENT OF HON. PETE WILSON, U.S. SENATOR FROM CALIFORNIA

Senator WILSON. Thank you very much, Mr. Chairman.

First, let me commend you for having moved quickly to schedule hearing on S. 2565, the Federal Telecommunications Policy Act of 1986.

As a cosponsor of the bill, I particularly appreciate your affording me the opportunity to appear before the Committee.

The confluence of the AT&T divestiture and developments in technology have presented all three branches of government with complex issues in need of resolution.

Sometimes the answers that are devised have a direct impact on consumers, such as the so-called access charges. But often the effects are indirect. In the bill before the Committee, the potential direct impact on consumers is enormously harmful, particularly if massive cross-subsidies are allowed to exist. But only—only—if the issues are not properly resolved.

I think that after careful review by the Committee, after all the issues have been adequately fleshed out, and after important modifications of the kind you've suggested have been made to S. 2565, the Congress can bring some needed order to the present web of regulation that has prevented increased competition and efficiencies in a number of markets.

At the outset of the Committee's consideration, it's important to establish that there is on reasonable basis on which to maintain the present system that oversees the business activities of the Bell regional holding companies.

The concerns that were addressed in the consent decree, and that have been carried out through continuing court review, can be well met through FCC oversight and rule-making. Those who believe that a consolidation of venue at the FCC would lead to undesireable results really oppose what they may wrongly fear to be a predisposition on the part of the Commission's members, not the Commission's jurisdiction per se.

I trust that the members of the Commission have not prejudged the issues. But in any event, in consideration of the fact that the

FCC is a creature of the Congress that pursues statutorily set goals, it would be far preferable for the bill's opponents to press for greater statutory guidance from the Congress for the Commission, rather than continuing to fight the venue question.

Mr. Chairman, I believe that the proposals that you have put on the table provide a very good focal point for the debate on safeguards; and that with temperate application, we can avoid the call of some to safeguard the bill to death.

But Mr. Chairman, injudicious use of putative safeguards in domestic telecommunications policy, even as in the case of international trade policy, can often serve to stifle competition, to dampen innovation, and to raise prices for consumers.

As I stated to you, Mr. Chairman, in my letter of August 14th, there are a number of safeguards that should be added by the Committee to S. 2565.

First, from a broad perspective, it is most significant to note that the breakup of AT&T occurred through Federal Court jurisdiction over our antitrust laws. Therefore, a change in venue that did not provide for FCC cognizance of the same antitrust concerns addressed by the court would be inadequate.

The concerns addressed by the publishing industry are not simply parochial, but really do speak to the public's interest in maintaining access to diverse sources of news. I know that the bill's sponsor, Senator Dole, as well as the Committee, is sensitive to this important First Amendment issue. And I trust that it will be properly resolved during Committee consideration.

And last but not least, there is the issue of safeguards for telephone subscribers, assuring that the rates they pay to the monopolist phone company do not go to pay for the operations of the entrepreneurist phone company.

How can these problems be addressed? Well, the first two regarding competitive advantage and electronic publishing, can be dealt with by Congress making difficult decisions and committing them to paper by precise drafting.

However the third issue, the protection of ratepayers, needs something more. I believe that the Committee must carefully consider requiring regular audits of the regional holding companies to ensure that there are no cross subsidies, and to ensure that the audits are thorough and effective, the unregulated activities of the regional holding companies should pay a cost-of-regulation fee.

My user fee proposal takes the same approach as the one I offered earlier this year to the bankruptcy court bill. That amendment, which was agreed to and is now in conference, directs the Judicial Conference to conduct a feasibility study of having the bankruptcy courts operate on a self-financing basis, perhaps by charging a variable fee for corporate reorganizations.

The idea is an old one and a simple one, but I think a good one: That those who use the services of the government for commercial purposes should shoulder the costs of those services.

My fear is that without a cost-of-regulation fee, any Congressionally mandated audit requirement may prove to be a toothless tiger, with a loud roar of warning, but no bite of enforcement.

The Committee has a very tough job before it. These hearings constitute a very important step along the road to bringing a complete bill before the full Senate.

And again, I thank you not only for your leadership in convening the hearing, but also for addressing a number of concerns with very positive suggestions.

The CHAIRMAN. Thank you very much, Senator Wilson.

Are there questions for Senator Wilson?

Senator Gorton? Senator Riegle? Senator Exon?

Thank you very much, Senator Wilson.

Next we have a panel of three House Members, Congressman Tauke, Congressman Swift, and Congressman Wyden.

Gentlemen, could you go down in front so we could see a little better? Thank you very much for being here and sharing your experience and your views with us, and also for your patience in waiting so long.

I don't know who would like to go first.

STATEMENTS OF HON. THOMAS J. TAUKE, U.S. REPRESENTATIVE FROM IOWA; HON. AL SWIFT, U.S. REPRESENTATIVE FROM WASHINGTON; AND HON. RON WYDEN, U.S. REPRESENTATIVE FROM OREGON

Mr. TAUKE. Mr. Chairman, we're happy that you wanted to see us this morning. And we're grateful to you, and commend you, for holding these hearings.

Since I introduced H.R. 3800 with Congressman Swift over on the House side, we have garnered over 170 cosponsors to that legislation, but we have not seen the legislative process move. And so these hearings are welcome.

In many ways, Mr. Chairman, our existing situation defies both logic and commonsense. The system under the consent decree has created a confusing, duplicative, and anticompetitive result.

That result jeapordizes our country's ability to, first, deliver to the public new and in many cases vital services. It jeapordizes our ability, secondly, to promote efficiencies that can keep telephone rates down. And thirdly, it jeapordizes our ability to maintain leadership in the international telecommunications market.

Let me elaborate for a moment on these points.

First, the Bell companies are strapped with restrictions that make it difficult for them to provide the full range of products and services their customers demand. We are entering a new age in information technology—one that offers the hope of a wide array of exciting products and services that can improve consumers' health, safety, and quality of life. But as long as the Bell companies are restricted from entering these fields, many of these services may never reach the public; or if they do, they will be only at a higher price. In the case of many rural areas, the only foreseeable way that residents can receive these services will be if they are provided by their local Bell operating company [BOC].

The FCC recognized this point in its recent Computer III decision, which will allow the Bell companies—after the appropriate regulatory and competitive safeguards have been met—to provide enhanced services on an unseparated basis. But this new freedom is illusory because it directly conflicts with the Consent Decree's ban on information services.

Second, I believe that the local telephone companies can guard against future rate hikes for their residential telephone subscribers by the cost-sharing and economies of scale that result when the telephone network facilities are allowed to be used by the Bell companies for offering new information services. Without those efficiencies, the companies risk being caught in an economic cul-de-sac, with no alternative but to raise rates to meet ever increasing costs and lessening demand.

In addition, the current system of "too many regulators in the kitchen" overly complicates and delays the process, making it more difficult to bring to market the new service offerings that can produce economies of scale and cost-sharing.

Finally, the Bell companies face restrictions which hamper technological development and dull the international competitiveness of this country. I know that Senator Danforth and others have worked aggressively to enact legislation aimed at providing American firms greater access to foreign markets. I applaud those efforts and believe it's a step in the right direction.

But the biggest market in the world for telecommunications is here in the United States—in fact, individually the Bell companies represent seven of the twelve largest markets and combined are the largest market in the world for telecommunications equipment. From the standpoint of trade, not to mention fairness, it doesn't make sense that seven experienced companies are prohibited from competing in such market. The divestiture decision, and the implementing orders, constituted an unprecedented, unilateral market opening. But, for the Bell companies, it constitutes a domestic trade barrier, as formidable as any faced by a U.S. company overseas.

The question is: Why shouldn't American firms, like the Bell companies, be able to participate in this market and sell products to the telephone companies in the United States—just as the Japanese, the Canadian, and the German companies are allowed to do.

Both S. 2565 and H.R. 3800 target the fragmentation of telecommunications policymaking. By consolidating the policymaking at the FCC, the expert regulatory agency, it permits coherent policy formation in an open forum by those accountable to the public through Congress.

H.R. 3800 and Sen. Danforth's proposed amendments go the next step, and explicitly provide, as a matter of national policy, for the removal of the consent decree barriers for BOC entry into new lines of business, so long as appropriate safeguards are in place.

It is important that that policy be made by the Congress.

In addition, Sen. Danforth's amendments embrace the same fundamental policies underlying the rate payer and competition protections Congressman Swift and I developed based on our Committee's hearing on H.R. 3800 and extensive informal discussions.

The remarks of my colleague, Congressman Swift, center on the substance of those safeguards. I want to limit my remarks to three points.

First, the most significant rate payer protection isn't in our amendments. It is the rate relief directly resulting from the sharing of the telephone network with the new ventures permitted under H.R. 3800.

Our legislation, with the proposed amendments, encourages that shared use. Shared use generates the economies of scale and cost sharing that can keep rates down, so long as there is fully accurate accounting.

This is not a subsidy. It is a benefit that rate payers should be entitled to when regulated facilities are used for new ventures.

Second, simple economics tells us that any safeguard that mandates a subsidy would distort the market, with the result that either the phone company is prohibited from entering a business, or, if it enters the business, it operates at a artificially high price that shelters inefficient competitors and misallocates resources.

Third, any legislation that requires more than a fair share of joint and common costs would discourage the joint or common use of facilities, thereby depriving subscribers of the primary rate protection otherwise available.

I guess, in short, we want to encourage joint and common use of facilities.

There are many who say, it is okay to lift the line of business restrictions. The issue is when, and under what conditions.

In November of 1985, when Congressman Swift considered offering amendments to the trade bill, the cries were: Wait for a hearing.

After introduction of H.R. 3800, we heard: Wait for equal access. Then: Wait for the Justice Department's report. Wait for Judge Greene to act. And just plain: Wait.

There are costs imposed by waiting, Mr. Chairman. For example, many services can substitute for equipment. Voice message storage and retrieval and call monitoring services are available to a purchaser of an answering machine.

Technically, those same services could be provided by the Bell Companies through their computer switches. But because those are prohibited information services, American consumers are denied a meaningful choice.

In most cases, if they want the service, they have to buy the equipment; equipment, incidentally, which is imported from overseas.

And once the decision is made to buy, the consumer no longer has an economic choice. He is not going to subscribe to something for which he already has the equipment.

In the last three years, the demand for this particular service has doubled. This year alone, an estimated 4.5 million answering machines, over 12,000 a day, will be bought by American consumers.

Of course, it is ~~to~~ someone's advantage—undoubtedly, the overseas manufacturer—to delay these service offerings. But I don't think it is in the consumers' interest.

The BOCs are barred from manufacturing under the decree. But as we have recently seen, the Court has authorized manufacturing so long as it occurs overseas, if that isn't unbelievable.

Besides the trade deficit cost, the loss of domestic manufacturing jobs, and the obvious exportation of associated research and development, delay in lifting the consent decree restrictions will result in more long term decisions being made under narrow and distorted policy considerations, such as this decision. It bars domestic manufacturing plants while allowing overseas manufacturing plants to be built.

Who benefits? I don't think it is the consumer. Nor, might I add, is it the working people of this country.

The telecommunications equipment trade deficit for the first half of 1986 stands at over $928 million. That is more than $5 million a day.

I suggest to you, in conclusion, Mr. Chairman, that the question should not be, why lift the decree restrictions, but rather the question should be, why shouldn't the BOCs be allowed to provide products and services to the American public now?

Those who argue that the Bell Company's entry into new lines of business is not in the public interest bear a very heavy burden. There are many who are already in the market that the Bell Companies would be allowed to enter; and we have heard from them all.

We owe consumers the opportunity to have the services that the new technologies can provide.

We owe rate payers the assurance that their telephone charges will not subsidize new ventures.

And we owe competitors in these lines of business protection from unfair competition.

But we do not owe them protection from competition itself.

The CHAIRMAN. Thank you, Congressman.

Congressman Swift?

Mr. SWIFT. Thank you very much, Mr. Chairman. I very much appreciate the opportunity to testify before you today.

Telecommunications is an evolving and dynamic industry that for too long has had its policy making made by the Justice Department and the courts with their too-narrow focus on antitrust and competitive concerns.

A broader focus is needed, and it's one that would consider other issues, such as universal service, international trade, local rates, and technological development.

To that end, let me observe that I think that it should be Congress' role to set the communications policy. And whatever legislation the Senate chooses to come up with, I think it would be a mistake if it delegated too many of the questions to the Commission without some policy guidance.

It's my observation that Congress has given very little policy guidance to the Commission over recent years in any of the areas of communication. And I would make it clear that I do not think that's because the FCC has usurped the authority; it is rather because Congress has abdicated it through inaction on a whole range of communications issues.

The kinds of things that I think Congress needs to give some guidance to lie in the following:

In line-of-business restrictions on the Bell operating companies, if those are lifted, consumers stand to benefit, I think, in three important ways if proper policy is followed.

First, when the basic telephone network is put to greater use, the fixed costs will be spread over more users. And with new services sharing costs, pressure on local rates go down.

Second, there are many services that are not offered today, or are offered only at rates that many potential users cannot afford, but which could be offered at affordable rates if we allow efficient use of the existing network.

And third, because the Bell Companies make up one-half of the domestic telecommunications industry, we assure the U.S. remains competitive in world markets by introducing seven significant players into the economy.

Because each of the latter two points—new products and services, and the impact on trade—have many capable and articulate advocates, let me focus my remarks on the benefit to ratepayers, and the need to make certain that they do not end up subsidizing new competitive ventures of the operating companies.

Mr. Chairman, I think that in an increasingly competitive environment, the inherent self-interest of all the players to maximize universal service is no longer present.

If any player realizes that he cannot keep his competitors from taking advantage of his investments, the likelihood is that no firm will make investments that subsidize its competitors; in this case, the investments necessary to preserve and protect universal service.

While in a regulated monopoly environment, a company could clearly benefit by making telephone service widely available by offering the lowest possible price, the present competitive environment poses a different set of economic imperatives.

Yet there can be real benefit to ratepayers of basic telephone service, by allowing new services to pick up their share of the costs of the basic telephone network. Sharing costs between existing and new services can take some pressure off local rates, and help preserve universal service.

But to insure that that will happen, and to insure that local rate payers benefit, we must make sure that costs are properly allocated, and that new services pay their fair share of the costs.

The risks that they won't are not insignificant, and must be dealt with very carefully.

Let me make clear that consumers will benefit not because there will be a subsidy of some sort. The advantage to rate payers will come in assuring that the benefits of any savings due to increased efficient use of the existing network will be shared equitably by both new services and customers of basic telephone service.

While I've tended to stress the ratepayer protection aspects of this approach, let me just note that it is also an approach that will protect competitors at the same time, since any subsidies that come out of ratepayers' pockets would go to disadvantage competitors who would have to compete against subsidized products and services.

Let me just note briefly that the concerns that have been raised by the newspaper publishers, which I know have been raised here as well, should be paid attention to, and some policy guidance should be given.

While the self-interest of the publishers in raising these concerns is obvious, I think, the concerns are legitimate, and I think it must be addressed in any legislation that is eventually enacted into law.

In summary, let me say that by addressing effectively the legitimate concerns of the publishers and the vital issues surrounding basic service customer rates, the effort to permit the Bell Operating Companies into competitive services can benefit the consuming public.

These are the kinds of Congressional direction that I mentioned earlier, if you're going to give substantially more authority to the FCC to conduct this telecommunication policy.

It is easy to talk about these particular ratepayer issues in the abstract. It is much more difficult to try and draft specific legislation to achieve them.

I am submitting with my testimony the results of a long and vigorous effort by myself and Congressman Tauke to develop a special ratepayer section that would be included as an amendment in our bill, H.R. 3300, and it may provide some direction or use for you as well.

And Congressman Wyden has some other views that I think would also be useful as to how to approach this.

I would commend this to your attention as a blueprint for action to protect rate payers, should the Senate decide to move on similar legislation.

Thank you very much.

The CHAIRMAN. Thank you, Congressman Swift.

Congressman Wyden.

Mr. WYDEN. Thank you very much, Senator. I very much appreciate your graciousness in allowing me to testify. I certainly won't give a long oration this morning. My colleagues have made a number of very helpful points.

Obviously, this issue is on the front burner, Senator and Committee members, and it just seems to me that it's critical that rate payers don't get burned as a result.

I think there are two major questions at issue. The first, and I think my colleagues have made a number of very good points on this, deals with the question of whether or not BOCs ought to be able to get into new lines of businesses.

Obviously, members in both the House and the Senate have differing views on this. I agree with my colleagues in the House that the BOCs ought to be able to enter these new fields.

The second question, and I think even more critical one at this point, is that if we do let the Bell Operating Companies get into new fields, and if we let the Federal Communications Commission monitor the process, how much wiggle room should we give the Federal Communications Commission to make decisions.

Mr. Chairman, I believe the answer to that question is, none. When I introduced the first piece of legislation in this area in November of 1985 I had very strong rate payer protections locked into that bill.

On August 15th of this year, along with four of my colleagues on the House Telecommunications Subcommittee, Mr. Luken, Mr. Bryant, Mr. Leland, and Mr. Synar, I placed in the Congressional

Record a specific roadmap for how we'd go about insuring rate payer protection.

The proposal that I and my House colleages on the telecommunications subcommittee are pursuing has gotten the strong support of the American Association of Retired Persons; the Consumer Federation; and the United Church of Christ.

Very briefly with respect to these rate payer protections, Mr. Chairman, the proposal assigns all direct costs of information services to those services; requires information services to pay a fair share of joint and common costs; makes information services pay for any new gadgets that are attached to the system which are installed for information services; and requires information services to compensate the rate payers for the intangible benefits to the Bell Operating Companies which rate payers have paid for over the years.

The rules governing the Bell Operating Companies' entry into the fields would be established by a federally dominated joint board.

This proposal, I think, is direct and clear. The FCC would implement the rules set up by the joint board, established under a law passed by the Congress.

The proposal wouldn't give carte blanche authority to the FCC to set communications policy, or to let the FCC's competition-at-all-costs philosophy run roughshod over the nation's longstanding commitment to universal service.

Like my colleagues, Mr. Swift and Mr. Tauke, I feel strongly that Congress must not continue to hand off responsibility for establishing telecommunications policy; it shouldn't hand off that responsibility to the courts, to the Justice Department, or to the FCC.

Now, our duty under the Communications Act notwithstanding, Mr. Chairman, there's ample evidence in my view to suggest that the Federal Communications Commission acting alone would not be able to reach a balanced conclusion about whether to allow the Bell Operating Companies to expand into other markets.

There are two reasons why I think that, Mr. Chairman. In 1983 Congress had to force the Federal Communications Commission to reconsider its access charge decision, under which it tried to shift most of the local telephone companies' cost burdens onto the consumers.

Second, Congress also had to push the FCC in establishing even the most limited lifeline program for needy telephone subscribers, a program which many of us still feel is inadequate as it stands today.

So Mr. Chairman, in conclusion, no member of the House or Senate wants to stand in the way of progress. Telephone service is obviously a necessity. Without it, the grocer can't call suppliers, auto dealers can't service their customers, and older people can't call their doctors.

As we move into the competitive communications era, we can't lose sight of the economic and social importance of the phone, or of our goal of universal phone service.

The last point that I'd mention, Mr. Chairman, is that I recognize that the proposal that I and my colleagues on the House Telecommunications Subcommittee have made doesn't address all of the issues of concern in the debate over whether to lift the line-of-business restrictions. There are many other important issues: the manufaturing questions; the legitimate concerns of competitors; the rights of communications workers. I'm going to be developing additional approaches on those questions.

I just think the rate payer issue stands far, far and away as the key issue in this, and that's why I've focussed on that.

Thank you for the time.

[The statement follows:]

Statement of Hon. Ron Wyden, U.S. Representative From Oregon

Mr. Chairman and Members of the Committee, thank you for this opportunity to testify on the most important issue in telecommunications today: how to move forward into the telecommunications age without telephone ratepayers getting burned. This is an issue about which many of my colleagues in the House feel strongly and I greatly appreciate the courtesy you have extended me in allowing me to testify before you here today.

Mr. Chairman, after more than a year of involvement in the debate over lifting the line of business restrictions on the Bell Operating Companies (BOCs), I have come to believe there are really only two major questions at issue.

Number one, should we let the BOCs into new lines of business? I happen to believe we should. Others do not.

Number two, if we do let the BOCs enter new fields, and if we let the Federal Communications Commission (FCC) monitor the process, how much wiggle-room should we give the FCC? The answer, I believe, is NONE.

Here's why:

When I introduced the first piece of legislation relating to lifting the line of business restrictions on November 5, 1985, I said the key was whether there were strong ratepayer protections in place up front—and my bill, HR 3687, The Telephone Ratepayer Protection and Technology Promotion Act of 1985, stated very plainly that such would have to be the case. On August 15 of this year, I, along with several of my House colleagues, Mr. Luken, Mr. Bryant, Mr. Leland and Mr. Synar, placed in the Congressional Record a proposal further refining how we would ensure ratepayer protections if the operating companies are allowed to engage in information services.

Our proposal, which has received support from consumer groups, including the American Association of Retired Persons, the United Church of Christ and the Consumer Federation of America, is very clear on how we would achieve that goal.

First, it states that any costs which can be attributed solely to an information service would be assigned directly to that service. If a cost cannot be attributed solely to an information service because it involves the use of facilities and resources that also are used to provide basic telephone service, it will be allocated equitably between information services and basic telephone service based on how much the information service actually uses those facilities and resources. The revenue resulting from the information services share of joint and common costs would then be channeled back into the rate base in order to reduce companies' revenue requirement for provision of basic service.

The Bell Operating Companies' information service operations also would be required to make a small contribution to the local exchange activities in order to compensate local ratepayers for having funded the development of certain intangible benefits—such as corporate goodwill, recognition, and reputation—that directly benefit the operating companies' information service operations.

Finally, this proposal gives State regulatory authorities—those best qualified to assess the needs of local ratepayers in their jurisdictions—a strong role in determining how costs will be allocated between information services and basic telephone service. The proposal requires the information of a Federal-State joint board which will set up the cost allocation rules to be implemented by the Federal Communications Commission (FCC).

In short, our proposal is very direct, very specific and very clear. The FCC will implement the rules set up by a Joint Board established under a law passed by Congress. The commission will not be given carte blanche to set telecommunications policy—or to let its competition-at-all-costs philosophy run roughshod over this nation's longstanding commitment to universal telephone service.

It's high time Congress took a stand. We must not continue to hand off responsibility for establishing telecommunications policy—not to the Courts, not to the Justice Department, and not to the FCC.

Congress has a duty under the Communications Act to give the FCC careful guidance. Our duty aside, there is more than ample evidence to suggest that the FCC—acting alone—would not be able to reach a balanced conclusion about whether to allow the BOCs to expand into other markets.

In 1983, Congress had to force the FCC to reconsider its access charge decision, under which it had tried to shift most of the local telephone companies' cost burdens onto consumers.

Congress also had to push the FCC into establishing even the most limited "lifeline" program for needy telephone subscribers, a program many of us feel is still inadequate.

Mr. Chairman, no one wants to stand in the way of progress. But neither do we want to return to the days before the Communications Act of 1934 when having a telephone was a luxury.

Telephone service is a necessity of modern life. Without it, grocers cannot call their suppliers, auto dealers cannot call their customers and elderly people cannot call their doctors. As we move forward into the competitive communications era, we must not lose sight of the economic and social importance of the telephone—or of our goal of universal telephone service.

Our proposal is designed to help us maintain our commitment to universal telephone service without erecting a barrier to technology. It also is designed to ensure that, as the BOCs have promised since this debate began, those who paid for our great telephone system—the ratepayers—will benefit from the BOCs entry into new fields.

One final commitment, Mr. Chairman. The Wyden-Luken-Leland-Bryant-Synar proposal does not address all the issues of concern in the debate over whether to lift the line of business restrictions. If these restrictions were to be lifted, I also would want to ensure that manufacturing issues and the legitimate concerns of competitors and communications workers were adequately addressed. I will be working on additional pieces to address these concerns at a later date.

Mr. Chairman, I would like to thank you for your leadership role on this important issue. I look forward to working with you, Mr. Tauke, Mr. Swift, and the others who share our concerns to ensure this goal is realized.

Thank you.

Congress of the United States,
House of Representatives,
Washington, DC, September 22, 1986.

Hon. John C. Danforth,
Chairman, Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senator Danforth: Thank you again for the opportunity to testify at the September 10 hearings on S. 2565 and related amendments.

I would appreciate it if the attached ratepayer protection proposal and section-by-section analysis, about which I testified at the hearing, could be included in the hearing record.

Thank you for your time and consideration.

With warm regards

Sincerely,

Ron Wyden,
Member of Congress.

Enclosure.[1]

The Chairman. Thank you, Congressman.

Are there any questions for this panel?

Senator Exon. Mr. Chairman, I have a question.

The Chairman. Senator Exon.

Senator Exon. Gentlemen, I welcome you from one forum to another. I have worked with many of you over the years on different panels, on different suggestions, and I guess primarily with regard to my colleague Al Swift.

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[1] The enclosure was not reproducible.

This whole business of deregulation started in the telephone industry before I came to the Congress. As you know, you each have had a part to play in that, as have all of us.

I compliment you for coming here today to reemphasize once again what remains I think an underlying concern here. That basically is whether or not we're going to allow the so-called free enterprise system to prevail to the potential harm of the individual ratepayer who needs a telephone, for total telephone service in this country of ours.

And, Congressman Wyden, I appreciated your remarks with regard to the Association of Retired People. They have a very legitimate concern here that I think tends to get lost sometimes as we go through all the deregulation matters.

A concern I have on the other hand, of course, is the fact that after all of the accomplishments or lack thereof with regard to deregulation, it seems to me that we are right back into the situation where, after having supposedly deregulated, at least to the extent under the pressures of the court, we are now back into the regulation field.

I don't happen to feel that the whole dergulation has been particularly good for the individual ratepayers around the country, the retired citizens and others similarly situated. And so I appreciate the fact that members of this committee and members on your committee in the House of Representatives are looking at that very carefully.

I think that has to be the underlying concern. I do not think it has been good for those individual ratepayers, this whole business of deregulation. The telephone bills are confusing. They don't understand them. They get different billings from different people.

So I compliment you for coming over here and underlining once again this situation that I think we have to look at as members of the Congress to see that those people are properly protected, because I don't believe the free enterprise system in this particular case is going to protect those unless we work something into that equation.

May I ask this question of you. In regard to the Justice Department procedures against AT&T. I never have quite figured out what caused that settlement to be made. I suppose it was the free enterprise system and moneymaking that had more to do with it than overall service to the people of this country.

But back then when this bill was being put together, was there testimony, was there discussion, was there an evaluation at that period of time as to when, if ever, we would take this matter out of the jurisdiction of the courts where I think it fundamentally does not belong, and return it to some agency of government under the Congress, which in this case is the Commission.

Now, having said that, I suspect that there are members around this table and members around your table that do not trust the FCC to do what we would like to have done. My bottom line is, was it considered in any detail at that time? Where do you think we are now? Where are we going in the future without possibly the total restructuring of the laws if we don't trust the members of the

FCC to make sure that those members are more responsive to th constituents that you and I represent?

Mr. SWIFT. Senator Exon, if I could take a swipe at that. No, I don't think there was any discussion or perhaps even an awareness of where we were going as those things were beginning to unfold.

Actually, probably the whole thing started to unravel back with the Carterfone decision 20 years ago and we had not realized that there was a seed growing that was leading to introduction of competition in a regulated monopoly and that would ultimately mean we would have to change the entire system.

There are still members of Congress who think they voted to break up the Bell System. They don't remember the vote. They sure as hell hope they voted right.

But they really think they have done it.

The fact is, the inaction of Congress in the policy area, permitted the Justice Department ultimately to sit down and negotiate what were essentially communications policy issues, which I think they were ill-equipped to do, while Congress stood around wringing its hands but refusing to move in and take the bull by the horns and do anything significant. That has left us now with a situation in which Humpty-Dumpty is broke and we have to do the best we can for the consumer, for the industry, for trade and all of those other issues that we have been talking about this morning, given the current situation.

There is no way we are going to go back and put Ma Bell back together again. We were not sure where we were headed then. I am not sure we are much clearer on where we are headed, except we know that we are not going to be able to just let this thing continue to unravel like Topsy and have any rational policy.

Congress, I think, is now trying to bestir itself and provide some leadership in that policy and the Dole bill is one part of that which will at least get it back in the proper administrative arena.

What I think we are all saying is that now Congress has got to go a step beyond that and Congress has got to take the lead in providing what the policy is that the proper administrative agency, the FCC, is going to be administering, to try and get a handle on and to try to get back on top of the telecommunications policy of this country.

Mr. TAUKE. Senator, if I might offer a couple of comments. First, that I want to underscore what Congressman Swift said; that it was a lack of congressional action that actually permitted the consent to create a move forward.

As you know, on both House and Senate side, there were many members who were pushing various approaches that would have established comperehensive telecommunications policies that would have achieved the same goals as the breakup of AT&T. But, because those efforts were unsuccessful, we were left with a court decision that could not take into account anything but antitrust considerations and therefore could not look at the broader telecommunications policy questions.

But as we look at this particular proposal, I would hope that you would see it not as much of a threat to ratepayers as an opportunity to protect ratepayers, because if we have an opportunity to use the system to a greater extent and properly share the costs for the use of that system, the greater efficiency in the system will mean lower rates for the average ratepayer across the country, and that is why we think this is an important opportunity that should be seized.

Now, we could blow the opportunity and hurt ratepayers, but I think that we should look upon it as an opportunity to help them.

I might just say if we do not seize this opportunity and we would maintain the monopoly in the local rate base, that I think that then we see a very bleak future for ratepayers, because down the road we know that this local monopoly that is currently in existence will be eroded by technology—it is today—but it will be eroded further by technology and so as a result we will have a declining rate base. And those who are stuck on it, the poor residential consumers, will pay an ever-greater share of the cost of maintaining that rate base because the network is not being shared by all kinds of other users.

So this has to been seen as an opportunity to protect ratepayers and if we don't take steps forward to use the network to the maximum extent possible, will hurt ratepayers down the road.

Senator **Exon**. Let me ask—you said our goal must be lower rates for consumers. Lower than what? Lower than it is today? Lower than it was before the system was broken up? Certainly you all have been involved as I have fighting these access charges that have been put in.

You don't believe, do you—well, maybe you do—that we can take some action to have the cost of a telephone in a ratepayer's home cheaper than it was before this new system was put into place for whatever reason?

Mr. **Tauke**. Lower than what it would be otherwise, Senator, I guess is the best answer.

Let me just say to you that I think the best way under a competitive system to ensure that the ratepayer has the best deal possible is to have the most efficient use possible of the network, of the system.

We are not going to go back to a system—at least I do not foresee us going back to a system where we will subsidize the local ratepayer as we did in the past. I think those days are behind us, for better or for worse. So now we have to figure out under this new competitive scheme how we give the ratepayer the best shake, and I believe the best way to do that is to have the most efficient use of the system possible and then ensure that the costs are properly allocated so the ratepayer is protected.

Mr. **Swift**. Well, I would largely agree with that, with this exception. The Senator specifically referred to the access charge and I don't want to be ungracious, but I would point out the House passed a bill that avoided all of those access charges and the Senate did not take it up.

What we got out of the FCC then was a $2 access charge, heading off a $6 charge. Now there is talk of going to $4 and one would suspect that my prediction, that all we were looking at was the thin edge of the wedge when the FCC started this, is beginning to look more and more true.

So maybe in another context, you and I could work on that.

Mr. **Wyden**. Senator, I might just comment.

The reason I am so concerned about ratepayer protection right now is I think that is what was forgotten the last time major decisions were made, and we just cannot tolerate that again.

My colleague from Washington made the point with respect to the access charges. We have had these access charges on the book a relatively short time and as I understand it, the major association of telephone companies already wants to put a doubling of those charges in place very, very soon. So the fear that a lot of us had, which was that the access charge decision initially was just a foot in the door—the idea was to get it in, no matter how small, so that you could then push on the gas and drive it as quickly as you could up and up and up—that threat is very, very real.

At this point in the telecommunications debate, let's not forget what we missed the last time; ratepayer protection.

Senator EXON. Is it true then that what you are saying, if I understand you, is that if some kind of a bill is enacted now, as past due as it might be from the standpoint of protecting the average consumer, that with proper direction we should now move this out of the courts and out of the jurisdiction of the Justice Department back to the FCC, but with specific guidelines that address the concerns that we both have.

Is that a fair way of placing it?

Mr. SWIFT. Exactly.

The CHAIRMAN. Gentlemen, thank you very much.

We now have a panel: Chairman Fowler of the FCC; Assistant Attorney General Ginsburg; Assistant Secretary of Commerce Sikes.

STATEMENTS OF HON. MARK S. FOWLER, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION; DOUGLAS H. GINSBURG, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE; AND ALFRED C. SIKES, ASSISTANT SECRETARY FOR COMMUNICATIONS AND INFORMATION, NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION, DEPARTMENT OF COMMERCE

Mr. FOWLER. Thank you, Chairman Danforth and members of the Committee. I am pleased to be here today to testify in support of S. 2565, the Federal Telecommunications Policy Act of 1986.

Before turning to that bill, I would like to commend you, Senator Danforth, and the members of this committee for devoting such high-level attention to today's issue.

At present, responsibility for Federal telecommunications policy development is split between the FCC and the United States District Court. The Department of Justice and Judge Greene have done a remarkable job overseeing the largest corporate reorganization in history and administering the AT&T and GTE consent decrees.

Despite this, I strongly support Senator Dole's conclusion that it is time to consolidate telecommunications policymaking and telecommunications regulation under the control of Congress.

Regulators involved in making fundamental policy choices that affect our entire economy must be responsible to the elected representatives of the American people. The FCC must answer, through you, to the citizens of this country. That is all that S. 2565 is about—no more, no less.

This legislation does not involve substantive decisions concerning the line of business decisions or other decree provisions. What it does involve is a fundamental decision concerning procedures and standards for review of the consent decree restrictions.

This is clear from the text of the bill itself. It does not say anything about changing the decree. Instead, it would require the Commission to adopt regulations identical in substance to the effective portions of the AT&T and GTE antitrust consent decrees. This would include existing line of business restrictions. It really is that simple.

You may believe the court administration of the consent decree restrictions has not been a problem so far. Why rock the boat now? Why stir up controversy? Again, the answer is fairly simple. Whether and how to modify the decree is one of the most important issues in telecommunications today. The stakes are very high and the final answer has to be right.

A decision this important requires assessment of U.S. trade interests, national security interests, the interests of competitors and, of course, the public interest. And it should be subject to congressional review.

The telecommunications and information industries will be the backbone of American economic development in the coming decades. We are now leaving the industrial age. We are in the information revolution. The decisions on whether or when to modify the consent decree restrictions and, if so, what safeguards to substitute, may have a fundamental effect on how well this sector of the American economy performs in years to come.

The Commission has not yet evaluated the line of business restrictions. If this legislation is passed, I honestly do not know what conclusions the Commission would reach. I would be less than honest, though, if I did not inform you that our Computer III proceedings have led me to hope that successful alternative safeguards could be developed at least in certain areas. An actual decision on the merits, however, must be based on careful evaluation of the full record on all relevant issues.

There is one area where the answer is clear. That is the need for a thorough, expeditious reexamination of the costs and benefits of these restrictions as measured against a broad public interest standard. There is no question that existing decree restrictions effectively prevent possible anticompetitive abuses by the Bell Operating Companies, but this protection comes with a very high price tag in terms of reduced competitive entry, lessened efficiency, and decreased service options for the American people.

No other country in the developed world keeps such tight controls in the form of flat bans on several of its hi-tech companies. We simply cannot afford to ignore these problems and delay determining if the procompetitive benefits of the decree restrictions can be obtained at a lower cost through other safeguards, short of total bans.

This translates into jobs for American workers and opportunities for American industry at home and abroad. It is important to emphasize, however, that any alternative safeguards must be developed and implemented with utmost care to ensure that they are fully effective. These safeguards must ensure full and fair use of Bell Operating Company facilities by their competitors, and include tight accounting controls to ensure that telephone customers don't pay a single penny for any competitive ventures.

If the BOCs were allowed to manufacture telecommunications equipment, safeguards would be necessary in this area as well.

The local companies are still dominant in offering local exchange service and access, although bypass alternatives are now available for many large business customers. Where competition doesn't exist, regulatory safeguards are necessary to prevent monopolistic abuse.

I am a deregulator, but I am also dead serious, Mr. Chairman, that regulation must be effective where monopoly services and facilities are involved.

I believe I can speak on behalf of all of my fellow commissioners in assuring this committee that this is our bipartisan commitment.

If decision-making about these matters is consolidated at the FCC, we will institute proceedings to examine these issues. Any decision will be based on a careful evaluation of a complete public record, including comments from all interested parties. The Commission will act with great care and I believe that our decision will be consistent with congressional concerns.

I am certain that you will hear from representatives of companies that see the seven regional companies and GTE as strong potential competitors. I expect that they will argue against S. 2565 on many grounds.

For example, one, "a deal is a deal." The theory behind this argument is that AT&T agreed to divestiture based on certain terms and conditions and that it would be fundamentally unfair for Congress to change it in any way.

Two, "vertical integration will inevitably result in letting the eight companies buy equipment from themselves and will cost American jobs."

And, three, "Fowler is not serious about controlling anticompetitive abuses."

Competitors predictably will say these things, but in closing I would like to briefly rebut them point by point.

Point one. Answer: No agreement should preclude prompt review of bars to American economic activity by Congress and the FCC. Only in this way can priorities such as national defense, competition, America's technological position in the world, trade and effects on public services and rates all be thoroughly evaluated.

An agreement between AT&T and the Justice Department, even when approved by the court, cannot restrict Congress' constitutional authority to regulate telecommunications. This is not a private matter between AT&T and the Justice Department. It has major economic implications for all Americans. Nor is this an illegal court stripping bill. Justice has reviewed this question carefully. It concluded that the bill is entirely consistent with the Constitution.

This is the view of the unified Executive Branch. Endorsement of S. 2565 by the Departments of Justice, Commerce and Defense bears this out. The Majority Leader of the U.S. Senate shares this view.

Point two. Answer: Possibly increased economic activity by the regional companies and GTE would likely promote American jobs. On the other hand, divestiture has certainly helped foreign manufacturers, together with American competitors. In fact, divestiture has prompted more successful foreign entry into the American market than any other American event, except perhaps this year's United States Tennis Open.

So I would suggest here, Chairman and members, that you follow the advice of disinterested parties, the government agencies.

Point three. Answer: My record as FCC Chairman and that of my fellow commissioners is that of people who have consistently cracked down on competitive abuses. My five and one half year record shows that I have not hestitated to regulate where there is monopoly power, and I underscore the FCC's record is one of bipartisan support for competition.

In closing, just a few weeks ago *The Economist* published a high technology survey comparing U.S. strengths and weaknesses in the world's information age economy against those of other leading edge countries. The article prominently cited our telecommunications regulatory regime as a decided strength.

I quote: "Even more than breakthroughs in telecommunications technology, America's new deregulated freedom to plug in, switch on, and sell an information service is breeding a whole new generation of 'infopreneurs.'"

Local rates are stable. In 1985 rates rose a modest 3.1 percent under the inflation rate. Telephone subscribers are at a record high: 92.2 percent. And interstate long distance rates are down 22 percent in just 2-1/2 years.

So, Mr. Chairman, I submit the record of the FCC stewardship is one to be proud of.

To sum up, Congress and the FCC have time enough in the future to weigh the pros and cons of each extra issue that will be raised beyond the scope of S. 2565, but five years have passed since divestiture was announced. The time is over-ripe for Congress to reclaim control of all important telecommunications policy issues.

The alternative, of course, is to step away from this issue because it's a hot one to handle, to do nothing. Ordinary American consumers who stand to benefit from congressional oversight do not much understand these jurisdictional questions. You probably have not heard much from any of them.

But you and I and members of the Executive agencies are here today because we have been elected or appointed on behalf of this quiet constituency.

Senator Danforth, we appreciate your leadership and that of this committee in taking on this important, somewhat contentious matter.

Thank you for your interest on behalf of the public interest.

[The following information was subsequently received for the record:]

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question 1. Yesterday, the Consumer Federation of America released a study which concluded that the American people are paying more for telephone service than they should. According to the CFA study, the Bell Companies earn a rate of return far greater than those of other American corporations. It appears that the Bell Companies continue to make more and more money, yet our rates continue to go up and up. Is this effective regulation? And if the Bell Companies are allowed to diversify, will regulators be able to safeguard customers?

Answer. With respect to the Consumer Federation of America ("CFA") report, first, we note that the report's findings concern local rates not subject to our jurisdiction. The long distance usage rates that we regulate have fallen some 22% since 1984. Second, while there were some relatively large local rate increases in 1983 and 1984, the rate of increase has slowed dramatically. We expect that trend to continue because the level of rate hike requests pending before state commissions has fallen from some $7 billion at the end of 1983 to approximately $500 million presently. We believe the states will continue their effective regulation of the Bell Operating Companies. Third, without going into details, we believe there are numerous flaws in the CFA report that seriously call into question its conclusions. Indeed, we think that these conclusions are no more accurate than CFA's previous research. In late 1984, the CFA predicted that "over two million people will do without phone service by June 1985 because of the rate increases that they experienced in 1984." Instead, between November 1984 and July 1985, more than 3 million people were added to the nation's telephone system.

We regret that the CFA has chosen to make its case in the press rather than in the context of a rate hearing where its analysis would be subject to careful scrutiny. Despite the opportunity to do so, CFA did not participate in our recent proceeding to set the authorized interstate rates of return for AT&T and the local exchange carriers. In that proceeding, we lowered the authorized rates of return from 12.75 percent to 12.0 percent and 12.2 percent for the local carriers and AT&T, respectively. Indeed, it appears that the authors of the CFA study did not even read the Commission's recent rate of return decision, because it is nowhere discussed, or cited, nor does it even appear in the bibliography.

In the Commission's recent rate of return decision, we were sensitive to the need to exclude the risks that relate to unregulated activities from the carriers' costs of capital. We specifically set rates of return that only encompassed the costs of capital that were associated with regulated interstate services. By prescribing rates of return in this restricted fashion, and monitoring the allocations of joint and common costs, we ensure that shareholders, not ratepayers, finance any unregulated activities of the carrier.

With regard to diversification, the accounting separation rules we are developing in Docket 86-111 are being designed to separate not only the costs, but also the profits and the risks, of competitive activities from the costs, profits, and risks of the regulated telephone business. This means that, if the telephone companies can make money in competitive ventures, that profit will accrue to the shareholders of the company; but, on the other hand, if they lose money in these competitive businesses, the losses will fall on the shareholders and not on the ratepayers. Our rules will ensure that ratepayers are not harmed by the existence of these competitive enterprises.

Question 2. Would local rates go down if the line-of-business restrictions on the Bell companies were lifted?

Answer. We have no numerical proof that lifting the line of business restrictions will lower local rates, in light of the many factors influencing such rate levels. It is our job to make sure that rates do not go up as a result of cross-subsidization of new enterprises. However, to the extent that assets which are currently being used only to provide monopoly services can be more fully utilized to provide both monopoly and new, unregulated services, a portion of the costs associated with the assets would be allocated to the unregulated services. Because the public switched telephone network is characterized by a large percentage of fixed costs, the increased usage of that network to provide information services should translate into greater efficiencies and cost savings for consumers. Increased network utilization would reduce the costs to be recovered from monopoly ratepayers and would keep local rates lower than they otherwise would be.

Question 3. Is the FCC better able today to regulate the Bell Companies and prevent anticompetitive behavior than it was before the antitrust suit against the Bell System?

Answer. The notion that the FCC was, and is, in 1986, unable to effectively regulate the activities of the Bell Operating Companies ignores the track record of the agency and the changes that have taken place in the telecommunications industry since 1974 (when the government filed the action which gave rise to divestiture). Significantly, in 1982, prior to divestiture, the Commission deregulated the provision of customer premises equipment (CPE) without financial dislocation to the local rate base. Despite arguments by AT&T, its competitors, and even other government parties that it could not be done, deregulation proceeded in orderly fashion resulting in a market that today is characterized by intense competition and cost-based pricing.

During the past twelve years, the Commission has developed, and continues to develop, improved regulatory techniques and controls. We are preparing systematic costing techniques to address the division of costs between regulated and nonregulated activities of the carriers, including a proposed oversight and enforcement mechanism. That mechanism will supplement our audit function with independent review of the cost allocation manual utilized by each telephone company, as well as the manner in which the company implements the procedures set forth in the manual. We also are reviewing the design and implementation of an automated information reporting system for the submission of carrier financial data to the agency. In addition, we have adopted technical guidelines and an oversight mechanism for carrier provision of enhanced services on an integrated basis to ensure the competitive provision of such services by alternative vendors. Carrier implementation plans must be submitted for public comment and Commission review prior to initiation of any integrated service.

It is crucial to recognize that the radical changes which have transformed the telecommunications industry have altered competitive and regulatory opportunities. The Regional Holding Companies are competing with one another and with AT&T. Because there now are eight entities instead of one, the Commission is able to compare the activities and policy positions of each company and its affiliates, as well as the impact of Commission rules on each individual entity. Based on our experience with the deregulation of CPE, we are "over the hump" in dealing with nonregulated activities, and can now refine our regulatory tools for dealing with other nonregulated activities.

In 1974 there were not examples of competitive market structure in telecommunications. The Commission was painting on a blank canvas. The prototype now, however, is in place and refinements are being made. In fact, we are seeing adoption of the competitive model by foreign countries in recognition of its feasibility and resulting consumer benefits.

Question 4. Do you think it is the Commission's role to guard against anticompetitive behavior?

Answer. The FCC has authority to enforce some antitrust laws. For instance, in Section 11 of the Clayton Act (15 U.S.C. $21) Congress gave the FCC the power to enforce compliance with Sections 2, 3, 7 and 8 of the Clayton Act (15 U.S.C. § 13, 14, 18 and 19) regarding transactions that inhibit competition, as these sections apply to common carriers.

Nevertheless, I do not believe that the Commission's dominant role should be to police the antitrust laws; rather it is to promote the overall public interest. Antitrust matters are generally within the expertise of the Department of Justice.

I do believe, however, that the FCC should take an active role in establishing the pre-conditions for effective competition in the communications marketplace. I have set as the FCC's number 1 objective the creation, to the maximum extent possible, of an unregulated comeptitive marketplace for the development of telecommunications. To this end, the Commission has taken several actions to promote competition. We have required AT&T and the BOCs to provide interconnection to customer-provided CPE, to alternate long distance carriers, and to enhanced services providers. We have ordered the regulated carriers to separate their costs into discrete rate categories, and we are currently investigating how best to categorize joint and common costs to prevent anticompetitive activity. Our Computer III decision, which requires AT&T and the BOCs to unbundle their basic service offerings into discrete components in Open Network Architecture plans, should also foster competition. Once these plans are approved, competitors will have the freedom to pick and choose the particular network elements they desire.

Consistent with these goals and activities, the Commission would be certain to analyze fully the competitive effects of any decision to relax any of the restrictions currently embodied in the MFJ.

Question 5. In may "paper hearing," a number of parties argued that the FCC should not be the forum for addressing these questions because the FCC has prejudged the issues. I would like to give you the opportunity to respond to that criticism.

Answer. I have always taken the view that issues remaining after divestiture more properly rested before the FCC. In comments submitted in the "public interest hearing" prior to entry of the AT&T decree, the FCC stated its opposition to the establishment of restrictions in the decree, and continuing administration by the court of these restrictions. However, this did not represent a predetermination by this Commission that there should be no restrictions on operating company activities, which would remain subject to examination by this agency in accordance with its public interest mandate under the Communications Act and subject to strict notice and comment procedures.

I do believe that the absolute prohibitions on BOC entry into the provision of information services and interLATA telecommunications services as well as telecommunications equipment manufacturing must be reexamined. These measures are very effective in preventing possible monopoly abuses by the BOCs, but they come with a high price tag in terms of reduced competitive entry and inefficiency. I believe that the line of business restrictions must be reexamined to determine whether alternative safeguards can successfully prevent possible monopoly abuses by the BOCs. Based on the Commission's record in the Computer III proceeding I must admit that I am hopeful that alternative safeguards could be used at least in certain areas. However, any decision on these issues must be based on a complete record including comments from all interested parties. I recognize that at present the BOCs retain a monopoly on ubiquitous access to the local exchange, although bypass alternatives are available, in many cases, for high volume business users. Any alternative safeguards would have to be carefully developed and implemented to ensure that they were fully effective in preventing abuses. Possible benefits from BOC entry would be lost if alternative safeguards were less than fully effective.

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS

Question 1. The Consent Decree with AT&T resulted from charges that AT&T violated the Sherman Act. Does the FCC have any jurisdiction over this law or any other involvement with it?

Answer. The Sherman Act grants enforcement authority over its provisions to the Justice Department. The FCC may, however, consider the antitrust considerations embodied in the Sherman Act under its mandate to uphold the public interest. The U.S. Supreme Court has suggested that in some cases, antitrust considerations alone may keep the public interest standard from being met. See, *United States* v. *Radio Corporation of America,* 358 U.S. 334, 351 (1959). In fact, a federal appeals court upheld an FCC decision to bar telephone companies from furnishing cable television service that was based solely on antitrust considerations. See, *General Telephone Company of the Southwest* v. *U.S.*, 449 F.2d 846, 856 (5th Cir. 1971).

The Commission has considered antitrust factors in the course of several proceedings. The FCC demonstrated its concern for antitrust policies by requiring telephone companies to allow interconnection of customer-supplied CPE and by competitive long distance carriers. The Computer I and Computer II decisions established the separate subsidiary requirements precisely in order to prevent the carriers from engaging in anticompetitive conduct against other CPE and enhanced services providers. Currently, the Commission is considering how telephone companies should best apportion joint and common costs between regulated and non-regulated services. This proceeding should prevent carriers from engaging in pricing strategies that discriminate against competitions.

In short, though the FCC has no direct authority to enforce the Sherman Act, its desire to promote effective competition and its duty to uphold the public interest require that it consider economic and antitrust factors in making its decisions.

Question 2. In the AT&T anti-trust case, AT&T alleged that the FCC had exclusive jurisdiction over common carrier matters. The court, however, rejected this claim and said that the FCC's regulatory oversight was not so prevasive that exclusive jurisdiction resided in the Commission. If the Commission was not capable of overseeing all the aspects of the common carrier industry in the past, particularly the anti-trust aspects, why will it now be able? In addition, if the court's jurisdiction over the MFJ is ceded to the FCC, why won't we find ourselves back in the same situation where we are today—with significant court involvement—in light of the Commission's capabilities?

Answer. The FCC never endorsed AT&T's views that the antitrust law did not apply to its conduct, because of the FCC's jurisdiction. Nor do we today believe that the Dole bill would immunize AT&T, GTE or the BOCs from antitrust violations.

The notion that the FCC was, and is, in 1986, unable to effectively regulate the activities of the Bell Operating Companies ignores the track record of the agency and the changes that have taken place in the telecommunications industry since 1974 (when the government filed the action which gave rise to divestiture). Significantly, in 1982, prior to divestiture, the Commission deregulated the provision of customer premises equipment (CPE) without financial dislocation to the local rate base. Despite arguments by AT&T, its competitors, and even other government parties that it could not be done, deregulation proceeded in orderly fashion resulting in a market that today is characterized by intense competition and cost-based pricing.

During the past twelve years, the Commission has developed, and continues to develop, improved regulatory techniques and controls. We are preparing systematic costing techniques to address the division of costs between regulated and nonregulated activities of the carriers, including a proposed oversight and enforcement mechanism. That mechanism will supplement our audit function with independent review of the cost allocation manual utilized by each telephone company, as well as the manner in which the company implements the procedures set forth in the manual. We also are reviewing the design and implementation of an automated information reporting system for the submission of carrier financial data to the agency. In addition, we have adopted technical guidelines and an oversight mechanism for carrier provision of enhanced services on an integrated basis to ensure the competitive provision of such services by alternative vendors. Carrier implementation plans must be submitted for public comment and Commission review prior to initiation of any integrated service.

It is crucial to recognize that the radical changes which have transformed the telecommunications industry have altered competitive and regulatory opportunities. The Regional Holding Companies are competing with one another and with AT&T. Because there now are eight entities instead of one, the Commission is able to compare the activities and policy positions of each company and its affiliates, as well as the impact of Commission rules on each individual entity. Based on our experience with the deregulation of CPE, we are "over the hump" in dealing with nonregulated activities, and can now refine our regulatory tools for dealing with other nonregulated activities.

In 1974 there were no examples of competitive market structure in telecommunications. The Commission was painting on a blank canvas. The prototype now, however, is in place and refinements are being made. In fact, we are seeing adoption of the competitive model by foreign countries in recognition of its feasibility and resulting consumer benefits.

Question 3. What jurisdiction does the Commission have over the manufacturing of equipment by a telephone company?

Answer. The Communications Act does not directly address Commission regulation of the manufacture of telephone equipment. The Commission does not currently license or control entry of telephone companies into manufacturing, but does regulate in certain areas which relate to such manufacturing activities. For example, the Commission policies the boundary between regulated and nonregulated activities with respect to the provision of telephone equipment by telephone companies in order to guard against cross-subsidization of the non regulated activities. In this regard, pursuant to our authority over interstate communications, the Commission has required the regional telephone companies after divestiture to establish a separate subsidiary corporation if they sell or lease telecommunications equipment to their customers.

The Commission also has established, under Title II of the Act, a registration program that provides standards for the interconnection of terminal equipment to the telephone network. Other provisions of Title II enable the Commission to regulate the charges, practices and classifications of carriers relevant to interstate and foreign communications.

Finally, the Commission also has ancillary regulatory powers under the Communications Act to the extent necessary to protect the public interest. This grant of ancillary jurisdiction has been illuminated by court decisions reviewing Commission exercise of this jurisdiction.

Question 4. Is there any doubt that the FCC has jurisdiction over the RBOCs and their operations? Have the RBOCs ever argued that the Commission does not possess such jurisdiction?

Answer. Title I of the Communications Act authorizes the Commission to make such rules and regulations and issue such orders, not inconsistent with the Act, as are necessary to execute its functions. Title II grants the Commission comprehensive authority over common carriers engaged in foreign or interstate communications. RBOCs have argued that this Commission lacks jurisdiction over them under either Title. However, it is settled that we do have certain authority over the RBOCs. For example, it has been held that the Act authorizes the Commission to require the holding companies to file plans of capitalization for the nonregulated activities of their subsidiaries, *see North American Telecommunications Ass'n v. FCC*, 772 F.2d 1282 (7th Cir. 1985); and that the Commission may require information and reports from the RBOCs, *see U.S. West v. FCC*, 778 F.2d 23 (D.C.Cir. 1985).

In both proceedings the subject RBOCs unsuccessfully argued that the Commission lacked the requisite jurisdiction.

Question 5. Last March, you told the USTA, "As many of you know, I support relaxing or eliminating most of the absolute bans in the MFJ." In May, in your statement on the Computer III Inquiry, you stated, "In spite of our giant step here today, a huge roadblock still lies ahead. The MFJ still restricts the seven regional companies from entry into many of these enhanced services. . .I know that my fellow Commissioners all agree that this obstruction must be removed—in the public's interest." Do these statements accurately portray your view on removing the restrictions on the RBOC's contained in the MFJ?

Answer. I have always taken the view that issues remaining after divestiture more properly rested before the FCC. In comments submitted in the "public interest hearing" prior to entry of the AT&T decree, the FCC stated its opposition to the establishment of restrictions in the decree, and continuing administration by the court of these restrictions. However, this did not represent a predetermination by this Commission that there should be no restrictions on operating company activities, which would remain subject to examination by this agency in accordance with its public interest mandate under the Communications Act and subject to strict notice and comment procedures.

I do believe that the absolute prohibitions on BOC entry into the provision of information services and interLATA telecommunications services as well as telecommunications equipment manufacturing must be reexamined. These measures are very effective in preventing possible monopoly abuses by the BOCs, but they come with a high price tag in terms of reduced competitive entry and inefficiency. I believe that the line of business restrictions must be reexamined to determine whether alternative safeguards can successfully prevent possible monopoly abuses by the BOCs. Based on the Commission's record in the Computer III proceeding I must admit that I am hopeful that alternative safeguards could be used, at least in certain areas. However, any decision on this issues must be based on a complete record including comments from all interested parties. I recognize that at present the BOCs retain a monopoly on ubiquitous access to the local exchange although bypass alternatives are available, in many cases, for high volume business users. Any alternative safeguards would have to be carefully developed and implemented to ensure that they were fully effective in preventing abuses. Possible benefits from BOC entry would be lost if alternative safeguards were less than fully effective.

Question 6. Do the RBOCs still have a bottleneck over local telephone facilities?

Answer. The BOCs, as well as the independent telephone companies, still have dominant control over the local distribution and switching plant. For the majority of users, this combined plant is the only means of access to interstate carriers or to the facilities of information service providers. However, large users of interstate telephone and data service can bypass the local plant and directly access interstate carriers such as MCI and AT&T over private communications links.

Although the BOCs will continue to control the major portion of the local loop distribution plant in the foreseeable future, the Commission has taken a major step toward remedying the bottleneck situation in the local switching plant. In its recent Computer III Report and Order, the Commission set in motion a procedure whereby the BOCs, and AT&T, will be required to implement, in their local switching offices, a system of Open Network Architecture. This will then permit any non-BOC supplier of information services, or communications services, to gain access to a BOC switch, and to the local distribution loops, on a basis that is equal in availability and quality to that enjoyed by the BOCs.

Question 7. There has been much talk about the FCC's Part X proceeding on accounting for common costs. When will this proceeding be completed? Will it enable the FCC to detect all forms of cross-subsidization? Does the FCC have the resources to implement and enforce accounting safeguards? Will the states follow the lead of the FCC?

Answer. We expect to issue an order in CC Docket 86-111 ("Part X") within the next few months. The accounting proposals in the Notice of Proposed Rulemaking were designed to facilitate the detection of cross-subsidies whether in the form of the misallocation of common costs or in the form of improper transfer pricing of transactions between telephone companies and their affiliates. The final rules will achieve these goals. Accounting rules do not and cannot deal with the problems which some perceive to exist with so-called "intangible cross subsidies," for example, the benefit that telephone company subsidiaries receive from being able to use the company name and associated good will. If a state believes that such benefits constitute cross subsidies it can handle the matter through ordinary rate making devices such as disallowance of expenses or imputation of revenues.

Implementation and enforcement of accounting safeguards will encompass the following activities: review and approval of cost allocation manuals; monitoring of the costs allocated pursuant to the manuals through review and analysis of routine data submissions; auditing; and investigation of complaints. The Commission's current resources are adequate for the review and approval of the manuals, monitoring, and complaint investigation. The Commission currently does not have sufficient resources to carry out by itself a comprehensive audit program. For this reason the Notice of Proposed Rulemaking proposed to supplement the Commission's own audit program with a requirement that each company submit annually the results of an independent attestation audit of the manner in which its cost allocation manual is being implemented. The Commission did not propose, however, to abdicate its responsibilities in favor of the independent auditors. We will set the standards that will guide the auditors, and our monitoring program will alert us to areas where we will want the independent audits to focus special attention. The independent audit results will in turn indicate to us where we can most effectively concentrate our own audit efforts.

In addition, we have proposed and discussed with members of Congress legislation authorizing the agency to charge for routine audits, up to a given dollar limit. Not only would such fees cover the expenses of these audits, but they would also create a strong incentive for the carriers to conform their accounting procedures and data to our rules and interpretations. Because the fees would be based on the direct costs of the audit, the corresponding fees would be minimized to the extent the carriers conform to FCC requirements. The appropriate allocation of the fees would be determined pursuant to the rules and policies adopted in CC Docket 86-111. Implementation of the fee program will enable us to perform on-site verifications of carrier data and permit further examination of carrier compliance.

Sixteen states have submitted written comments in the proceeding. Some of them appear to believe that the recent Supreme Court decision *(Louisiana Public Service Commission)* means that the Commission cannot prescribe cost allocation rules for nonregulated activities; of these a few express vehement opposition to anything we might do in this area. Others appear interested in adopting whatever reasonable approach we can devise. The majority of states did not comment at all. From this we can assume that some states will go along with us while others will not. Whatever the outcome of the jurisdictional question, the states would in any event retain full authority to regulate the state rate base. Any accounting mechanism adopted by the Commission for realizing an appropriate split of joint and common costs between regulated and nonregulated telephone company activities would preseve intact the established separations process whereby costs in the companies' regulated accounts are allocated to the state and interstate jurisdictions, with the state commissions having full authority over the recovery of the state revenue requirement, including making disallowances as permitted by state law. The FCC would, of course, retain its undisputed authority to make any appropriate disallowances from the interstate revenue requirement for regulated services.

Question 8. In a recent speech the Chief of the FCC's Common Carrier Bureau stated, "The fact that the LECs (local exchange telephone carriers) can't get their access tariff filings right seriously undermines their efforts to gain approval for entry into new competitive ventures. . ." I strongly agree with this statement. Does the FCC have difficulty in obtaining accurate information for other tariff filings and for any other purpose? Is this a longstanding problem? When will the FCC have control over this situation? Does the FCC believe this lack of accurate information has any affect [sic] on the ratepayer safeguards adopted in its Computer III inquiry?

Answer. Obtaining accurate and complete access tariff cost support data is indeed a complex problem that is far more significant with respect to access filings than in other areas. The local exchange carriers' difficulties in compiling access support data are derived from the major changes in operations and roles required by the new access rules and divestiture of the Bell System. The lack of experience in the access tariff area in the post-divestiture environment does not generally apply to other filings. Further, our access tariff filing requirements are more rigorous than for prior filings so as to insure greater accuracy and uniformity. However, there has also been significant progress towards resolving the transitional problems, and the Commission is determined to continue to take the steps necessary to ensure that carriers will provide complete and accurate access tariff material.

One such effort culminated in the Access Tariff Review Plan, adopted in an Order released by the Common Carrier Bureau on August 15, 1986. This Plan was developed to identify specifically the materials we expect carriers must file in support of annual access tariff revisions due October 3, 1986. Under the Plan, responsible corporate officials must certify that access tariff filings are true, correct and complete. The officials will be subject to prosecution for any willful false statements.

An example of complexities of these problems and the efforts the Commission and the carriers have made to solve them is the process of calculating the basic figure of total minutes of interstate access use. The Bureau staff discovered a discrepancy between the total figure compiled for all carriers by the National Exchange Carrier Association (NECA) and the sum of the figures for the individual carriers. If this anomaly had not been discovered, rates might have been much too high. The Bureau staff worked with the carriers to analyze and correct this problem, which was largely a result of inconsistent methodologies by some carriers and miscalculations. In the Tariff Review Plan, we have sought to eliminate the inconsistencies and to require carriers to demonstrate that they have corrected the problem.

Moreover, in a recent letter addressed to local carriers, the Common Carrier Bureau Chief outlined the Bureau's concern with carriers' compliance with the Commission's access charge rules with respect to revisions proposed for special access rates. The letter requires the carriers to submit revenue and cost data for a number of subcategories of special access service.

In general, therefore, we believe that the accuracy of data submissions will be greatly improved once the carriers have acquired additional experience and have committed sufficient resources to accomplish this task. An added incentive towards this end has been the Bureau's demonstrated ability to independently analyze and revise enormous volumes of cost and demand data using its own internally developed computational and analytical tools. These activities are all geared to assist the Bureau in meeting its objective of performing rapid and thorough analysis of financial and economic data submitted with tariff filings so that savings from overstatements of costs or revenue requirements can be immediately passed on to the public without the need for protracted investigations. The Bureau has already demonstrated that a sophisticated data surveillance system can operate successfully by requiring immediate and significant reductions in access charges filed over the past two years. The carriers recognize, therefore, that failure on their part to generate acceptable data can result in the Bureau's interjection to generate acceptable data can result in the Bureau's interjection of its own, generally conservative views of the proper rate levels.

We take a similar view of the Computer II safeguards. Those were adopted after careful analysis, and only after the Commission was assured that the safeguards adequately protect ratepayers from potential abuses involving anti-competitive conduct. We remain confident that these alternative safeguards are well conceived and designed, but we agree that they must be implemented properly by the carriers if they are to be fully effective. Our structural separation requirements for the provision of enhanced services would remain in effect until we are satisfied that the carrier can successfully implement an "Open Network Architecture" (ONA) plan that meets the guidelines set forth in Computer III. These plans must be filed by February 1, 1988 and will be subject to public comment and pre-implementation review and approval by the Commission. Interim provision of a given service or class of services is permitted on a nonseparated basis provided that the carrier satisfies our requirements for the "comparably efficient interconnection" (CEI) of these services. However, CEI, like ONA, cannot be implemented before public comment and Commission approval. Oversight of carrier activities will continue through our audit function and complaint process to ensure proper implementation and ratepayer protection.

Question 9. What should be the role of the states in protecting the ratepayer against subsidizing unregulated ventures of the RBOC's? In ensuring that the RBOC's do not discriminate against competitors of its unregulated ventures?

Answer. The Commission continues to believe that the states have an essential role to play in protecting against improper cross-subsidies between regulated and non-regulated activities and against anti-competitive discrimination by the RBOCs. State regulation focuses primarily upon preserving the integrity of the state rate base for purposes of regulating intrastate services and the rates therefor. The states also inquire into whether the costs assigned to the intrastate jurisdiction by the separations process are appropriately disallowed for recovery from the ratepayers of regulated services. Through this oversight, the states can protect ratepayers from improper cross-subsidization among intrastate services or anti-competitive discrimination against competing intrastate service providers. Because the states are concerned with the state rate base, however, state oversight cannot ensure against improper cost shifting among interstate activities.

Question 10. Is the Commission satisfied with the progress of equal access in the long distance market? Does it believe this process is substantially completed?

Answer. The equal access implementation process is proceeding on the schedules for implementation that were filed by each Bell Operating Company during 1984. The seven regional holding companies (Ameritech, Bell Atlantic, Bell South, NYNEX, Pacific Telesis, Southwestern Bell, and U.S. West) had, by the end of the second quarter of 1986, converted approximately 58,500,000 lines—about 63% of the total—to equal access.

As background information, the MFJ required that the Bell Operating Companies (BOCs) convert 1/3 of their lines to equal access by September 1, 1985. No percentage requirement is imposed for 1986. Instead, the MFJ provides that "upon bona fide request, every end office shall offer such access by September 1, 1986." No definition of "bona fide" is provided nor does the MFJ indicate how long the BOCs might be allowed before converting an office after such a request. In end offices employing switches technologically antecedent to electronic, stored program control switches and in those offices served by switches that characteristically serve fewer than 10,000 lines, the MFJ also provides that a Bell Operating Company may not be required to provide equal access if it can be shown that for particular categories of service such access is not physically feasible except at costs that clearly outweigh potential benefits to telecommunications users.

Indications are that the initial MFJ requirement that the BOCs convert 1/3 of their lines by September 1, 1985 was exceeded, with about 44% of the lines coverted by the end of the third quarter of 1985. For the seven regional holding companies, conversion to equal access has proceeded at a pace which achieved conversion of approximately 58,500,000 lines by the end of June 1986, as previously noted. The following table shows the quantities of lines converted to equal access at year end 1984, at year end 1985, and by the end of March 1986. Based upon information received from the regional holding companies, it is estimated that offices containing approximately 73% of the lines will be converted by the end of 1986. The balance of the offices are of the older type or are otherwise exempt from the conversion process at this time.

APPROXIMATE BOC EQUAL ACCESS CONVERSION

Period	Total lines converted (in millions)	Cumulative percent of lines converted
1984—Yearend	3.6	4
1985—Yearend	46.7	51
1986—2d quarter	58.5	63
1986—Yearend (estimated)	68.3	73

QUESTIONS OF SENATOR RIEGLE AND THE ANSWERS

Question 1. I would like to get as clear a picture as I can from each of you as to how you view the health and state of the long distance marketplace? For example what is the current market share, as best you have determined it, of each of the top 5 long distance companies?

Answer. At the present time, competition in the long distance marketplace appears healthy and vigorous. Since 1984, the number of customers served by each of AT&T's two largest competitors (MCI and Sprint) has doubled. At the same time, the number of long distance competitors has also continued to grow rapidly. We estimate that there are approximately 185 long distance carriers that purchase equal access from local telephone companies and a total of nearly 500 carriers in the long distance market.

Because the Commission has decided not to impose the burdens of economic regulation on carriers that do not possess market power, smaller carriers are exempted from the FCC's reporting requirements. As a result, we have no data that allow us to calculate their market shares.

The Commission believes AT&T continues to possess substantial market power even though its share of the interstate market has now fallen to about 80%. For this reason, the Commission continues to classify AT&T as a dominant carrier and AT&T's services continue to be regulated by the Commission. Nevertheless, the long distance industry is, in many ways, strikingly similar to the computer industry: we have one large dominant firm offering a full range of premium services, several much smaller firms attempting to compete head-to-head with the industry leader, and a very large number of much smaller firms seeking to either establish themselves in the industry or to serve specialized segments of the industry. While the industry has not yet become perfectly competitive, it is rapidly becoming more so.

We have attached two items that provide information on the rapidly developing long distance market. The first item consists of charts showing the growth of MCI and Sprint. The second item[1] is a recently issued report that shows the numbers of long distance carriers and the states in which they operate.

Number of customers served by MCI

March 31, 1976	16,000
March 31, 1980	41,000
March 31, 1981	280,000
March 31, 1982	734,000
March 31, 1983	1,179,000
March 31, 1984	1,613,000
December 31, 1984	2,173,000
June 30, 1985	2,631,000
September 30, 1985	3,088,000
December 31, 1985	3,487,000
March 31, 1986	4,087,000
June 30, 1986	4,485,000

Sources: 1979 through 1984: MCI Annual Reports to Stockholders. 1985 through 1986: MCI Analytical Abstract for the Quarter Ended June 30, 1986.

Number of customers served by Sprint

1979	47,000
1980	80,000
1981	200,000
1982	535,000
1983	943,000
1984	1,347,000
1985	1,956,000
1986	2,600,000

Sources: 1979 through 1984: GTE Annual Report, 1984. 1985: GTE Annual Report, 1985. 1986: GTE Shareholder News, 1986 Second Quarter Report

Question 2. It is my understanding that AT&T's current authorized return on investment is 12.75% and that their return through the first 6 months of 1986 is somewhere between 14-15%. I am also told that next year their authorized return on investment will be 12.2%.

I have a number of questions regarding this subject.

First, am I accurate with respect to AT&T's authorized return on investment?

Second, how serious is the Commission about getting AT&T's return on investment down to 12.2%?

Third, how would you expect AT&T to get down to its authorized 1987 return unless it further cuts its rates to consumers?

Fourth, what would an additional rate reduction on the part of AT&T do to AT&T's competitors? In other words what would the impact of another AT&T rate reduction be on MCI, U.S. Sprint and a number of the other long distance companies, virtually all of whom are currently losing money?

Fifth, how competitive do you think the long distance market is at the moment?

Answer. The Commission, at a meeting held on August 7th of this year, lowered AT&T's authorized rate of return from 12.75% to 12.2%, effective January 1, 1987. The lower rate of return will be in effect for two years. The Commission is very serious about carriers not exceeding maximum rates of return, and will enforce the rate of return ceilings through two processes—the tariff review process and the automatic refund regulations contained in Part 65 of our Rules.

While we cannot prejudge AT&T's tariff filings, absent a decline in traffic volume or an increase in other costs, we would expect AT&T to cut its rates to consumers on January 1, 1987. Both AT&T's access costs and authorized return on investment will be lowered as a result of our August 5th action. We would expect other interstate carriers to follow AT&T's action, if AT&T does lower rates. We do not anticipate any harm to the other carriers, however, because they also will benefit from lower access costs and they already have experienced declines in their costs of capital due to the lower levels of interest rates.

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[1] The attachment was not reproducible.

As indicated in our response to Q.1., competition in the long distance market appears healthy and vigorous. Consumers today have the choice of numerous carriers and optional calling plans, as well as the ability to select a primary long distance carrier for "1+ dialing." Indeed, we have found that there are nearly 500 interstate carriers serving in one part or more of the United States.

Question 3. A number of people believe that as far as each of you on this panel are concerned it is not a question of "if" but rather "when" the BOCs are allowed into (1) Information Services, (2) Manufacturing, and (3) Long Distance.

As far as each of you are concerned is it more a matter of "if" or a matter of "when" and what are the issues involved in each of these areas?

Answer. The absolute bars to BOC entry into the provision of information and interLATA services as well as equipment manufacturing must be reexamined. Whether these prohibitions should be replaced by alternative safeguards depends on whether such measures would be fully effective in preventing possible monopoly abuses by the BOCs. Such a determination must be based on a complete record including comments from all interested parties, although the record developed in the Computer III proceeding makes me hopeful that alternative safeguards could be developed. However, at present the BOCs have a monopoly on ubiquitous access to the local exchange, although bypass alternatives are making inroads in terms of access to high volume users. Any alternative safeguards would have to be developed and implemented very carefully to ensure that they would be fully effective in preventing possible monopoly abuses. Any benefits from BOC entry would be lost if the alternative safeguards were not fully effective.

Question 4. I would like each of you to give me your views on what you believe is the remedy to reversing the tremendous deficits not only in telecommunications but in all electronics based products? For example, the 1985 deficit in telecommunications products was $1.5 billion and is expected to reach $1.6 billion in 1986.

According to trade statistics from the Department of Commerce, electronics based products will go from a $7.4 billion surplus in 1980 to almost a $16 billion deficit. (Electronics based products include telecommunications, computers, components, consumer products, office products and electronic measuring instruments.)

What regulatory and other actions, if any, do you believe should be implemented to reverse this critical and unacceptable telecommunications and electronics trade deficit?

How do you account for, and what is the cause of, our tremendous telecommunications trade deficit?

Answer. I believe that we must make vigorous efforts to promote the liberalization of foreign telecommunications and data processing markets. Towards that end, the FCC has engaged in telecommunications policy discussions over the past year with representatives from a wide variety of countries, including, for example, Japan, Canada, France, West Germany and Finland. In these discussions we have made a strong case for the competitive model for the telecommunications industry, and have pointed out that telecommunications competition in the United States has resulted in technological advances, new products, lower prices, and improvements in efficiency that have benefitted the entire U.S. economy. We have also made clear our belief that the new market access opportunities that liberalization provides are not restricted to national firms or to firms that have a substantial investment in that country. Moreover, in addition to providing technical assistance to our trade representatives in the successful U.S.-Japan telecommunications trade discussions, the FCC co-chaired technical telecommunications policy discussions concerning proposed laws or regulations in Spain and the Federal Republic of Germany.

These FCC actions represent my belief that it is almost inconceivable that any significant liberalization of foreign telecommunications infrastructures will take place without a long and hard look at the results of divestiture and deregulation in the United States. Moreover, thus far many countries have been exposed only to the myths and distortions about deregulation and divestiture that serve to buttress, rather than challenge, the traditional telecommunications monopolies abroad. As a result, the telecommunications discussions we have had with foreign governments, including discussions related to telecommunications trade demonstrate that an active FCC presence is required.

At the same time, however, we recognize that the FCC is not a trade agency. As a result, we have limited resources, both in terms of staff and travel funds, to devote to telecommunications trade discussions. We believe that the FCC should, indeed must, continue to engage in serious telecommunications policy discussions with foreign administrations, both on a political and a technical level, but given our limited resources, these efforts must be focused on the countries that represent either the largest potential market for U.S. telecommunications equipment manufacturers and service providers, or those most likely to liberalize. We therefore believe it is important to work closely with the Office of the United States Trade Representative and other executive branch agencies, such as NTIA, to ensure that the U.S. government engages in more effective telecommunications liberalization efforts.

With regard to the telecommunications trade deficit, the U.S. market *is* open to foreign suppliers of telecommunications goods and services. This is, in large part, a result of the pro-competitive policies that have been pursued by the U.S. government and supported on a bipartisan basis. These policies has resulted in enormous benefits for the consumer. The average price for key telephone systems and private branch exchanges in the United States have declined, for example, by over 50% and 20% respectively over the last several years. Moreover, this telecommunications equipment, as well as the terminal equipment used in American homes, now includes a wide variety of new features that increase customer choice and efficiency.

Moreover, in the long distance marketplace, prices have declined by over 20% over the last two years. This has resulted in greater and more efficient use of the telecommunications network and stimulated the American economy, including the creation of new jobs for U.S. workers. At the same time, however, the residential penetration rate has climbed to an all-time high of 92.2%.

The openness of the American telecommunications environment has led not only to an improvement of the best telecommunications network in the world, but also to a clear recognition of the United States as a leader in telecommunications.

The telecommunications deficit therefore is primarily a result of the fact that foreign telecommunications markets are not as open to U.S. telecommunications firms. Therefore, the actions described above to open foreign telecommunications markets, and provide their consumers and telecommunications service providers with the same benefits of liberalization that the United States has experienced, deserves immediate and sustained attention by the U.S. government.

The CHAIRMAN. Thank you, Chairman Fowler.

Assistant Attorney General Ginsburg.

Mr. GINSBURG. Thank you, Mr. Chairman and members of the committee. I am very pleased to be here today to discuss S. 2565 as introduced by majority leader Dole. I have a prepared statement which I would like to submit for the record, and with your permission I will make brief oral remarks at this time.

I think the members of the committee are well informed about the contents and significance of the bill from their own study and from the previous remarks that are made today. I would like to devote my attention to some additional points instead of summarizing the bill any further. In particular, Chairman Danforth, you have suggested a number of amendments to S. 2565, and noted a number of questions raised by those possible or proposed amendments. The Department of Justice is not in a position at this point to provide useful answers to those questions, unfortunately. Many of them involve highly techincal and complicated matters of technology and telecommunications policy, and in fact the complexity of this entire subject is well reflected in those questions that you have raised, and I would suggest further that this technical complexity points up the limitations of the Department of Justice as the telecommunications regulator.

For now I will only suggest that most of the questions that you have raised would be addressed more profitably by the Federal Communications Commission, which has considerably more experience and more resources to address those questions in this critically important area. The Administration and the Department of Justice, however, strongly support S. 2565 as introduced by Senator Dole.

The Department is currently engaged in a comprehensive study of the changes that have occurred in the industry during the nearly three years since the AT&T divestiture, and that study, which has not yet been completed, will attempt to gather the facts that are necessary in order to address some of the questions that you have raised, Mr. Chairman. Others, unfortunately, will not be addressed because our study will deal solely with issues relevant to competition policy.

We will be reporting our findings in January, 1987, and making recommendations on behalf of the Administration either to the FCC or to the Decree Court or to both, depending upon whether S. 2565 or similar legislation has been passed and on whether the decrees have been vacated.

Obviously, given our current ongoing work, I am not in a position now to conclude whether the restrictions that the decrees place on AT&T, the BOCs, and GTE and its subsidiaries are still necessary or have in fact become outmoded, but I do want to stress that it is not because we disagree with the policies underlying the decrees or with the court's decisions enforcing them that the Administration supports this legislation.

Rather, it is because the current decree regime has created an inefficient parallel system of Federal regulation for the telecommunications industry with the Federal Communications Commission, on one track and the Department of Justice and the Decree Court on the other. Since January, 1984, the Department has received more than 110 requests for waivers of the decree restriction on the business activities of the Bell operating companies.

Analyzing many of these requests requires a major commitment of the Department's staff and supervisory resources, and almost all of them require lengthy periods for third party comments, Department decisionmaking on whether to support the request and under what conditions, and, ultimately, court action on those waiver requests. The Department and, I firmly believe, the court neither expected nor desired such a result when the decree was entered in 1982.

Unfortunately, however, the complexities of the decree and the conflicting interest of AT&T and the BOCs and the other telecommunications firms have brought the court and the Department to a point where we are acting respectively as the regulator and the regulatory staff necessary to the administration of these decrees.

Now, of course, the FCC, unlike the court or the Department, is a regulatory agency with a broad regulatory mandate from Congress and administrative expertise and procedural and remedial flexibility that is necessarily greater than our own. Moreover, experience has shown that it is very difficult to coordinate the Commission's exercise of its statutory responsibilities with the Department's and the court's enforcement of the decrees.

Thus it is imperative that the present dual regulatory system be replaced by a unitary system based in the expert agency, the FCC, that can best ensure that the regulatory regimes embodied in the decrees are implemented in a manner consistent with other telecommunications-related regulations and policies. It is time for the Department of Justice to return to its traditional role of investigating and prosecting Federal antitrust violations.

The bill, S. 2565, also possesses the great virtue of allowing important factors to be taken into account in carrying out the decree's regulatory scheme that cannot now be addressed by the court such as national security interest, the interest of local telephone users, and the significant role of telecommunications in international trade.

The Commission's broader public interest standard would also permit it to consider a different mix of criteria to determine whether the particular restrictions now found in the decrees should be retained or rescinded or modified. That sort of regulatory flexibility represents sound public policy.

Importantly, however, S. 2565 would not by itself change any operative provision of either of the decrees. Any efforts to alter the operative provisions of the decrees during the legislative process, as has been proposed by some of the earlier witnesses today, could enmesh the Congress and this committee in the micromanagement of the regulatory process and create needless statutory complexities.

Moreover, significant disparities between the legislation and the decrees might cause uncertainty in the court about the legal impact of the legislation on the decrees and thus about the extent to which it could be vacated. When the legislation is passed and the court vacates the decrees, the Commission would have the power and an appropriate process, namely, rulemaking by the expert agency with full public comment through which to make apropriate changes in the regulatory regime now embodied in the decrees. Most importantly, perhaps, that regulatory process is one that is responsive to Congressional oversight in a way that is simply not possible under the present judicial process.

I think, therefore, it is extremely important that the Congress act quickly to consolidate regulatory responsibility for the telecommunications industry and the FCC. Otherwise, the current fractured state of jurisdiction will continue to cause confusion, delay, and uncertainty.

If the Congress has not transferred this authority prior to the beginning of next year, consideration and implementation of the recommendations for regulatory change that arise out of the Administration's 1987 report, both the Department study and NTIA's forthcoming update of its prior report, will be mired in a morass of jurisdictional conflicts and overlaps. Requiring that this necessarily complex process be carried out under the current scheme of divided Federal agency and court regulation will only needlessly compound the difficulties.

Mr. Chairman, that concludes my remarks. I thank you, and I am happy to answer any of your questions.

[The statement follows:]

STATEMENT OF DOUGLAS H. GINSBURG, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. Chairman and Members of the Committee. I am pleased to be here today to discuss S. 2565, the "Federal Telecommunications Policy Act of 1986." The bill, introduced by Senate Majority Leader Dole, would consolidate federal regulatory authority over the telecommunications industry in the Federal Communications Commission. The bill would (a) require the Commission to promulgate a detailed set of regulations identical in substance to the consent decrees entered in the *AT&T* and *GTE cases,*[1] *(b) empower the Commission to remedy violations of the regulations, (c)*

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[1] United States v. AT&T, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 460 U.S. 1001 (1983); United States v. GTE Corp., 603 F. Supp. 730 (D.D.C. 1984).

empower the Commission to modify or rescind, and to grant exemptions and waivers from, the regulations, and (d) provide that violations of the regulations shall not be deemed to constitute violations of any existing antitrust decree. After the bill is enacted, motions would most likely be filed with the district court to vacate the AT&T and *GTE* decrees, reasoning that the continued existence of the decrees would be inconsistent with the regulatory authority given to the Commission by the bill. The court would likely decide to vacate the decree for precisely that reason.

The Administration strongly supports this legislation. In fact, if it is passed by Congress in the form outlined above, the Department of Justice would be prepared to move the district court for vacation of the decrees.

Chairman Danforth has suggested a number of amendments to s. 2565. He also noted a number of questions raised by the proposed amendments. The Department is not in a position, at this point, to provide useful answers to these questions—many of which involve highly technical and complicated matters of technology and policy. In fact, the complexity of this entire subject is well reflected in the questions he has raised, and I suggest further that this technical complexity points up the limitations of the Department of Justice as a telecommunications regulator, which I will address further in a moment. For now, I will only suggest that most of the questions he has raised would be much more profitably addressed by the Federal Communications Commission, which has considerably more experience and more resources to address questions in this critically important area.

A. THE IMPACT OF THE DECREES IN THEORY AND PRACTICE

The AT&T decree, which was signed over four and one-half years ago, has brought about one of the most significant industrial restructurings in our country's history. The decree was designed to foster competition in long-distance service by requiring the 22 Bell Operating Companies (BOCs) to provide all long-distance companies access to the BOCs local exchange networks that is equal to the access provided to AT&T. This process was begun in 1984 and is scheduled for substantial completion by the end of this month.

The decree also limits the BOCs generally to providing local exchange telecommunications and exchange-access services unless a waiver is obtained from the decree court. The line-of-business restrictions in the *AT&T* decree and the related waiver process essentially require the decree court to regulate the BOCs' entry into new businesses. To date, waivers subject to conditions have been granted to allow the BOCs into practically every business that they have sought to enter, other than information service, interexchange (*i.e.*, long-distance) service, and telecommunications equipment manufacturing.

The decree's line-of-business restrictions were based on historical and analytic factors indicating that two competitive dangers may arise when firms that control natural monopolies and that are rate-regulated, such as the BOCs, participate in adjacent competitive markets. First, as a rate-regulated monopolist, a BOC has the incentive and may have the ability to limit competitive rivals' access to its monopoly facilities—the local exchange network. Second, a BOC may try to engage in anticompetitive cross-subsidization of its competitive lines of business.

The *AT&T* decree was intended to foster competition in the interexchange and information services markets among companies other than the BOCs by requiring affirmative technological changes through the equal access process. At the same time, by imposing limitations on the BOCs' entry into non-local and exchange-access markets, the decree was intended to remove their incentive to retard competition in nonregulated markets.

The three-year old *GTE* decree was designed to structure and regulate the entry of the General Telephone Operating Companies into long distance as a result of GTE's acquisition of Sprint, a long-distance carrier. Rather than excluding GTE from nonregulated businesses, it regulates GTE's participation in certain markets. Despite its different approach, the *GTE* decree addresses competitive concerns similar in kind to those present in *AT&T*.

The competition-based policies on which the *AT&T* and *GTE* decrees were founded have conferred significant benefits on American consumers. Since divestiture, major aspects of the telecommunications industry have become more competitive and thus have been characterized by the introduction, at an unprecedented pace, of innovative products and services coupled with dramatic price reductions. For example, a November 1985 report by the National Telecommunications and Information Administration (NTIA) estimated that the per-line price of key telephone systems would decrease by 25 percent in 1985 alone, at the same time as technological advances made such systems more versatile than ever before. In the market for telecommunications equipment, the per-line price of certain central office switching equipment has been cut in half. And in the market for long-distance services, AT&T for example has reduced its rates time and again, making the price of direct-dialed calls 25 percent lower than it was at divestiture; indeed, for certain large customers, AT&T's long-distance charges are only one-half of what they were at that time. Finally, while the price of flat-rate local exchange service has increased by approximately 25 percent in the first two years after divestiture, this increase is better explained by other factors, such as inflation and regulatory changes, that have nothing to do with the divestiture. On balance, both residential and business customers are paying less for their overall telephone service than they were prior to divestiture by taking advantage of the new competitive environment.

B. THE DEPARTMENT'S REASONS FOR SUPPORTING S. 2565

The Department and its consultant, Mr. Peter W. Huber, currently are engaged in a comprehensive study of the changes that have occurred in the industry during the nearly three years since the AT&T divestiture. That study, which is not yet complete, will attempt to gather the facts necessary to address some of the questions raised by Chairman Danforth (others are not addressed, or are addressed only indirectly, because the study focuses solely on issues relevant to competition). We will report our findings in January 1987, either to the FCC or to the decree court, or to both, depending on whether S. 2565 or similar legislation has been passed, and on whether the decrees have been vacated. Obviously, I am not now in a position to conclude whether the retrictions that the decrees place on AT&T, the BOCs, and GTE and its subsidiaries are still necessary or have become outmoded. But I do want to stress that it is not because we disagree with the policies underlying the decrees, or the court's decisions enforcing them, that we support this legislation.

Before divestiture and in the early post-divestiture period, the Department had important responsibilities for monitoring, on behalf of the court, the steps that AT&T and the BOCs took to make divestiture work. We still must oversee the process of conversion to equal access, which is scheduled to be substantially completed this month. But it has become increasingly clear to us that day-to-day administration of the decrees should ultimately become the responsibility of the FCC.

The current decree regime has created an inefficient parallel system of federal regulation for the telecommunications industry, with the Commission on one track, and the Department and the decree court on the other. Since January 1984 we have received over 110 BOC requests for waivers of the *AT&T* decree's line-of-business restrictions. Analyzing many of these requests requires a major commitment of the Department's staff and supervisory resources, and almost all of them require lengthy periods for third-party comments, Department decisions on whether to support the request and on what conditions, and court action on the waiver request. The Department—and I believe the court—neither expected nor desired such a result when the decree was entered. Unfortunately, however, the complexities of the decree and the conflicting interests of AT&T, the BOCs, and other telecommunications firms have brought the court and the Department to the point where we are acting respectively as the regulator and staff necessary to the administration of the decree.

Of course, the Commission, unlike the court or the Department, *is* a regulatory agency, possessed of a broad regulatory mandate from Congress, an administrative expertise, a procedural and remedial flexibility, and a staff capacity devoted to telecommunications regulation that is necessarily greater than our own. Moreover, experience has shown that it is very difficult to coordinate the Commission's exercise of its statutory responsibilities with the Department's and the court's enforcement of the decrees. Thus, it is imperative that the present dual regulatory system be restored to a unitary system based on the expert agency—the Commission—that can best ensure that the regulatory regimes embodied in the decrees are implemented in a manner consistent with other telecommunications-related regulations. It is time for the Department of Justice to return to its traditional role of investigating and prosecuting federal antitrust violations.

The bill also possesses the great virtue of allowing important factors to be taken into account in carrying out the decrees' regulatory schemes that cannot now be addressed by the decree court, such as national security interests, the interests of local telephone users, and the significant role of telecommunications in international trade. The Commission's broader "public interest" standard would also permit it to consider a different mix of criteria in determining whether the particular restrictions now found in the decrees should be retained, rescinded, or modified. Such regulatory flexibility represents sound public policy.

The Department also believes that S. 2565 is plainly constitutional and does not improperly intrude on the province of the courts to administer judicial decrees. This is not a "court-stripping" bill. Rather, Congress has the power under the Commerce Clause to impose regulations such as those contained in the decrees, and a court, through an injunction or consent decree, cannot oust Congress from the exercise of powers that the Constitution delegates to the legislature. Indeed, if Congress changes the substantive law while a court order either is on appear or has become final but remains executory—as these decrees are—then the courts must enforce the new substantive law as Congress has declared it. The courts will have an opportunity to decide whether the decrees must be vacated in whole or in part in order to reflect the changed legal circumstances and to avoid frustrating the comprehensive new regulatory scheme established by Congress.

S. 2565 would not by itself change any operative provision of either decree. As I have already stated, at this time the Department is not prepared to conclude that any particular changes in the decrees are justified. Once the Huber report is in and the range of reasonable proposals for change has been identified, however, the responsibility for sorting through, selecting, and implementing those proposals should be assigned to the single most competent and expert agency available to do the job—the FCC. Moreover, Congress will be able to play a much more direct role in the process if it is conducted by the FCC.

Any efforts to alter the operative provisions of the decrees during the legislative process could enmesh the Congress in micromanagement of the regulatory process, and create needless statutory complexities. Moreover, significant disparities between the legislation and the decrees might cause uncertainty in the courts about the legal impact of the legislation on the decrees, and thus about the extent to which the decrees should be vacated. When the legislation is passed and the court vacates the decrees, the Commission will have the power and an appropriate process—rulemaking by the expert agency with full public comment—through which to make appropriate changes in the regulatory scheme now embodied in the decrees.

I believe that it is extremely important that Congress act quickly to consolidate regulatory responsibility for the telecommunications industry in the FCC. Otherwise, the current fractured state of federal telecommunication regulation will continue to cause confusion, delay, and uncertainty in the telecommunications industry. Moreover, if Congress has not transferred authority over the decrees' regulatory regime prior to the beginning of the next year, consideration and implementation of recommendations for regulatory change arising out of Mr. Huber's report and NTIA's forthcoming update of its 1985 report may be mired in a morass of jurisdictional conflicts and overlaps. Requiring that this necessarily complex process be carried out under the current scheme of divided federal agency and court regulation will needlessly compound the difficulties.

S. 2565, as I have explained, will substantially reduce the difficulties of the process. But to be effective, S. 2565 must be passed this year. If, after the FCC has stored through the myriad of facts, policies and proposals, Congress disagrees with any of its conclusions, Congress can then legislatively override them.

In sum, the Department strongly supports S. 2565 bill as the appropriate solution to our current, unsatisfactory system of dual regulation of the telecommunications industry.

Thank you.

QUESTIONS OF SENATOR RIEGLE AND THE ANSWERS

Question 1. "A number of people believe that, as far as each of you on this panel are concerned, it is not a question of 'if' but rather 'when' the BOCs are allowed into (1) information services, (2) manufacturing, and (3) long distance.

As far as each of you are concerned is it more a matter of 'if' or a matter of 'when' and what are the issues involved in each of these areas"

Answer. Telecommunications regulatory experience over past decades indicates that technology and commercial change will increasingly blur any lines of demarcation between and among offerings. The AT&T consent decree establishes a number of lines of demarcation which almost certainly will be changed eventually. There is no reason to assume these lines will provide more durable than have others in the past. Indeed, the Competitive Impact Statement filed by the Antitrust Division of the U.S. Department of Justice in 1982 at the time the decree was proposed indicated a desire to eliminate any artificial lines and restrictions when changed market conditions rendered them obsolete. The judgment court, moreover, has indicated that it does not consider the consent decree restrictions necessarily fixed and immutable but rather amenable to future change, as competitive circumstances warrant.

The consent decree establishes criteria regarding possible relaxation or elimination of the restrictions now placed on the Bell companies. The basic issue in all instances generally is whether entry by the Bell companies into a new line of business would have an anticompetitive effect on the market they seek to enter. In the case of "information services," the issue has also arisen whether there is a significant likelihood certain new services will be made available to ordinary residential telephone subscribers if the Bell companies are not permitted to offer them. In the case of manufacturing, issues have been raised regarding the effect on U.S. imports and exports, should the Bell companies be permitted to enter this field. In the case of long-distance offerings, issues including the national security implications of additional telecommunications networks have been raised. Some parties have also advanced issues regarding the predictability of Government policies in this capital intensive sector should the present restrictions on the Bell companies be abruptly removed.

As indicated in Assistant Secretary Sikes' statement to the Committee regarding S. 2565, the range of important issues raised is such as to make review by the Federal Communications Commission functioning under the broad "public interest" standard of the Communications Act preferable to continued review by the judgment court which must necessarily confine itself to relatively narrow antitrust and competition policy concerns.

Question 2. "I would like each of you to give me your views on what you believe is the remedy to reversing the tremendous deficits not only in telecommunications but in all electronics based products? For example, the 1985 deficit in telecommunications products was $1.5 billion and is expected to reach $1.6 billion in 1986.

According to trade statistics from the Department of Commerce, electronics based products will go from a $7.4 billion surplus in 1980 to almost a $16 billion deficit. (Electronics based products include telecommunications, computers, components, consumer products, office products, and electronic measuring instruments.)

What regulatory and other actions, if any, do you believe should be implemented to reverse this critical and unacceptable telecommunications and electronics trade deficit?

How do you account for, and what is the cause of, our tremendous telecommunications trade deficit?"

Answer. Telecommunications trade deficits are a function of several interrelated factors including: (a) persistent barriers to U.S. competition abroad, notwithstanding open U.S. domestic markets; (b) currency imbalances; (c) Government regulation hobbling the ability of leading U.S. firms to compete; (d) certain of the restrictions currently placed on the Bell companies; (e) lower priced offerings due to lower wage rates abroad; and (f) lack of long-term involvement by many U.S. telecommunications companies in international trade and commerce. Critical to stemming the rate of trade deficit growth and, over time, correcting the present bad U.S. trade situation are efforts including talks and negotiations aimed at reducing foreign trade barriers and the elimination of unnecessary Government constraints which limit the ability of U.S. communications firms to compete more effectively both at home and abroad.

The CHAIRMAN. Thank you.

Assistant Secretary Sikes.

Mr. SIKES. Mr. Chairman, thank you very much for this opportunity to express the Commerce Department's strong support for S. 2565. Let me say that I have submitted my full testimony for the record and Mr. Chairman, there are several points that I particularly would like to make. We believe that prompt enactment of this proposed legislation is essential. Most importantly, it would reaffirm the constitutional responsibility of Congress through the FCC to regulate a major part of the American telephone business. It would also reduce the likelihood of duplicative or conflicting government signals in a very critical high-tech sector. Accomplishing these reforms, in our judgment, is highly desirable given the extreme importance of telecommunications to our international commerce and national security.

S. 2565 would simply vest the duty to administer the consent decree in the expert agency. The 1982 AT&T consent decree basically established a regulatory scheme for the companies which comprised the former Bell System. It placed extensive obligations on these firms, such as the duty to provide equal access to local telephone exchanges and to use open, nondiscriminatory procurement. It also placed, as you know, a number of restrictions on the businesses that AT&T and the divested Bell companies can engage in.

We believe the FCC is the most appropriate Federal agency to administer this regulatory system for a number of reasons. First, the FCC obviously has far more resources and in-house expertise than the District Court. The FCC has hundreds of engineers, economists, accountants, and attorneys on its payroll with extensive knowledge and experience in telecommunications.

The questions which initially arose under the consent decree may have been relatively simple and straightforward. Those that will arise in the future will be much more complicated. It seems to us that we are most likely to get the right answers by relying on the expert agency and not a single Federal judge.

Second, the FCC, unlike the Court, already has established arrangements through which it can solicit and obtain expert advice and recommendation from State regulators through its Federal-State joint board procedures. The FCC can tap the resources of State agencies on a regularized basis. I might add, as somebody who has spent eight years in State government, that I think the States' role in respect to telephone rgulation is an essential role, and therefore the FCC's particular position should be as the principal and, not necessarily the single regulator of the telephone industry.

The obvious problem with respect to Congressional oversight is the problem of having different Federal entities with overlapping responsibilities trying to regulate the telephone industry. Simply stated, it cuts down on the Congressional oversight which I think is critically important. These are not just insider issues. I think that these are public issues and need to be carefully considered in the various public fora.

There is an undeniable need for telephone regulation, but at the same time there is a need to centralize the responsibilities in this critically important sector which carries burdens all the way from universal service to sunrise industrial sector. We must have accountability and not a system which invites finger pointing when things go wrong. We need to know who is in charge to hold them accountable. Consolidating Federal regulation of the telephone industry in the FCC will not eliminate all problems of potential conflict. It will, however, be a good step toward that objective, and it will facilitate, as I have said, effective Congressional policy control.

Now, let me comment on steps that the FCC has taken. I have listened to witnesses today who are critical of the FCC, but I think it is important to note that the FCC has taken affirmative steps to require local telephone companies to provide what is called comparably efficient interconnection and eventually open network architecture with respect to that new class of services called information services. The FCC also has proceedings under way to develop improved cost accounting rules and procedures for the telephone industry, in order to minimize the possibility of anticompetitive cross-subsidies or ratepayer abuse.

These are very commendable regulatory initiatives. They also have a direct bearing on some of the restrictions now placed on the Bell companies under the consent decree. Having developed the safeguards, the FCC is in a good position to assess whether current restrictions are needed. The FCC will also be better able to develop rules and procedures in this area because it has more flexibility than the District Court. Safeguarding competition is an important national goal, but it is only one factor, albeit a major one, in the overall public policy calculus.

The FCC, functioning under the public interest standard of the 1934 Communications Act, has the flexibility to balance among sometimes conflicting policy objectives. The District Court, in contrast, has indicated that it feels constrained to consider issues from a relatively narrow antitrust perspective.

Now, Mr. Chairman, let me turn briefly to the question of trade consequences, the trade implications of our current regulatory scheme.

While we support passage of S. 2565 as it is now drafted, we also understand the concerns you have raised. In particular, let me address the proposal that the FCC be required to consult with the Secretary of Commerce, the United States Trade Representative, and other appropriate Executive branch officials regarding the international trade and competitiveness effects of possible AT&T consent decree changes.

Let me at the outset say that no other person in Government has a better understanding of the trade problems that we now face in telecommunications than you. We certainly share many of your concerns, and have given this particular proposal or amendment considerable thought. International trade obivously is increasingly critical in telecommunications.

In 1982 we had a trade surplus of about $200 million in the relatively narrow category of telephone and telegraph equipment. In 1986 we are projecting a deficit of $1.6 billion. Resolving the international trade problems we face in this key high tech sector constitutes a major Commerce Department priority. The actions the FCC might take regarding the AT&T consent decree could certainly affect our international trade and thus the success of the Department's ongoing programs.

Let me hasten to add, however, that we already work closely with the FCC on a number of telecommunications trade fronts. The FCC has participated, for example, in several of the trade talks we conducted with European administrations and the Japanese. We have also consistently maintained that international trade consequences are an integral component of the broad public interest standard under which the FCC operates.

Formalizing a trade consultative process would ensure that what is now being done on an informal basis would continue. Given the importance of trade implications, that step would be positive. We do not, however, believe any given Federal agency's opinion should preclude the FCC from acting in a particular way after considering all the public interest factors.

In conclusion, Mr. Chairman, I would like to reiterate my support for the bill, and I thank you very much.

[The statement and questions and answers follow:]

STATEMENT OF ALFRED C. SIKES, ASSISTANT SECRETARY FOR COMMUNICATIONS AND INFORMATION, DEPARTMENT OF COMMERCE

Mr. Chairman and Members of the Committee: Thank you for this opportunity to express the Commerce Department's strong support for S. 2565.

We believe prompt enactment of this proposed legislation is essential. Most importantly, it would reaffirm the constitutional responsibility of Congress, through the Federal Communications Commission (FCC), to regulate a major part of the American telephone business. It would also reduce the likelihood of duplicative or conflicting Government signals in a critical "high-tech" sector. Accomplishing these reforms, in our judgment, is highly desirable, given the extreme importance of telecommunications to our international commerce and national security.

As you know, the bill would only change the primary responsibility to administer the AT&T and GTE consent decrees. It would not alter the various "line of business" restrictions that apply to the Bell companies and AT&T. Nor would the bill remove any of the current safeguards that are designed to foster full and fair competition. Instead, S. 2565 would simply vest the duty to administer the consent decree in the expert Federal regulatory agency, rather than the Federal judiciary.

The 1982 AT&T consent decree basically established a regulatory scheme for the companies which comprised the former Bell System. It placed extensive obligations on these firms, such as the duty to provide "equal access" to local telephone exchanges, and to use open, nondiscriminatory procurement. It also placed a number of restrictions on the businesses that AT&T and the divested Bell companies can engage in.

We believe the FCC is the most appropriate Federal agency to administer this regulatory system for a number of reasons. First, the FCC obviously has far more resources and in-house expertise than the District Court. The FCC has hundreds of engineers, economists, accountants, and attorneys on its payroll with extensive knowledge and experience in telecommunications. The District Court, by comparison, has a handful of law clerks, together with whatever data it can glean from briefs and petitions filed in adversarial judicial proceedings.

The questions which initially arose under the consent decree may have been relatively simple and straightforward. Those which will be arising in the future, however, will be increasingly difficult and complex.

It seems to us that we are most likely to get the right answers in the future by relying on the expert agency in the field, instead of a single Federal judge.

Second, the FCC—unlike the court—already has established arrangements through which it can solicit and obtain expert advice and recommendations from state regulators. Through its Federal-state joint board procedures, the FCC can tap the resources of state agencies on a regularized basis. The FCC is intimately familiar with the two-level regulatory system established under the 1934 Communications Act. It is better equipped to minimize the chance of Federal-state regulatory conflict than the court.

Third, there is the matter of congressional oversight. It has been noted that pluralism is a characteristic of our Federal establishment, because the structure of the Executive branch tends to mirror the Congressional committee system, where overlapping jurisdictions are common. The obvious problem with having different entities with overlapping responsibilities trying to regulate the telephone industry, however, is that one not only maximizes the possibility of duplicative or conflicting signals. One also makes effective oversight by Congress, often a difficult task, even harder.

There is an undeniable need for telephone regulation. At the same time, there is an undeniable need to centralize Federal responsibilities. In this critically important sector—which carries burdens all the way from "universal service" to "sunrise industrial sector"—we must have accountability, and not a system which invites "finger pointing" when things go wrong. We need to know who is in charge, and to hold them accountable.

Consolidating Federal regulation of the telephone industry in the FCC will not eliminate all problems of potential conflict. It will, however, be a good step toward that objective. And, it will facilitate more effective Congressional policy control.

Not only is the FCC the best place to consolidate Federal regulatory controls from a process standpoint. The FCC also has a strong and commendable track record when it comes to promoting full and fair competition.

Recently, for example, the FCC took affirmative steps to require local telephone companies to provide "comparably efficient interconnection" and, eventually, "open network architecture" with respect to that new class of communications offerings usually called "information services." The FCC also has proceedings underway to develop improved cost accounting rules and procedures for the telephone industry, in order to minimize the possibility of anticompetitive cross-subsidies or ratepayer abuse.

These are not only commendable regulatory initiatives. They also have a direct bearing on some of the restrictions now placed on Bell companies under the AT&T consent decree. Having developed the safeguards, the FCC is in a good position to assess whether current restrictions are needed. The FCC should have a better sense for how effective its safeguards actually are than may be true of a single Federal judge, who may not be fully informed about Federal and state regulatory developments.

The FCC will also be better able to develop rules and procedures in this area because it has more flexibility than the District Court. Safeguarding competition is an important national goal. But it is only one factor, albeit a major one, in our overall public policy calculus.

The FCC, functioning under the "public interest" standard of the 1934 Communications Act, has the flexibility to balance among sometimes conflicting policy objectives. The District Court, in contrast, has indicated that it feels constrained to consider issues from a relatively narrow antitrust perspective. As Assistant Attorney General Ginsburg has indicated, the Administration believes consent decree decisions should be made taking into account more than just antitrust concerns.

While we support passage of S. 2565 as it is now drafted, we also understand some of the concerns which the Chairman has raised. In particular, let me address the proposal that the FCC be required to consult with the Secretary of Commerce, the U.S. Trade Representative, and other appropriate Executive branch officials regarding the international trade and competitiveness effects of possible AT&T consent decree changes.

Let me say at the outset that I expect no other person in Government has a better understanding of the trade problems we now face in telecommunications than this Committee's Chairman. We certainly share many of Chairman Danforth's concerns, and have given this particular proposal considerable thought.

International trade, obviously, is increasingly critical in telecommunications. In 1975, for example, combined imports and exports represented only 5.3 percent of total telephone equipment sales in the United States, but they amounted to some 16.2 percent of the total last year. Not only has the volume of trade in this sector more than tripled in the past decade. Especially since 1982, the United States has found itself in an increasingly severe deficit situation.

In 1982, we had a trade surplus of about $200 million in the relatively narrow category of "telephone and telegraph equipment." In 1986, however, we are currently projecting a deficit of about $1.6 billion. In the broader category of "electronics-based products," which encompasses both communications and related computer products, we had a $4 billion trade surplus in 1982. Last year, however, we had a $10.4 billion deficit in this category, and we are forecasting a deficit of about $16 billion for 1986.

Resolving the international trade problems we face in this key "high-tech" sector constitutes a major Commerce Department priority. Any actions the FCC might take regarding the AT&T consent decree could certainly affect our international trade, and thus the success of the Department's ongoing programs in this field.

Let me hasten to add, however, that we already work closely with the FCC on a number of telecommunications trade fronts. The FCC has participated, for example, in several of the trade talks we conducted with European administrations and the Japanese. We have also consistently maintained that international trade consequences are an integral component of the broad "public interest" standard under which the FCC operates.

We do not believe, for instance, that the FCC could find a particular action was in the "public interest," if it were faced with record evidence indicating the action would have severe adverse international trade effects. Nor do we believe this FCC would take any such action, given the concerns which Chairman Fowler and FCC officials have expressed regarding our current trade predicament.

Formalizing a trade "consultative process" would assure that what is now being done on an informal basis would continue. Given the importance of trade implications, that step would be positive. We do not, however, believe any given Federal agencies' opinion should preclude the FCC from acting in a particular way, after considering all the "public interest" factors.

In conclusion, Mr. Chairman, let me reiterate that we believe the national interest would be furthered by prompt passage of S. 2565. Telecommunications is a pivotal part of our economy. We should work to minimize the possibility of duplicative or unnecessary Government constraints. I would also like to commend the Committee's expert staff for the effort they have made to develop legislation which is satisfactory to all of the many groups with a legitimate interest in this Congressional initiative. We stand ready, of course, to provide whatever further assistance the Committee and its staff may need.

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question 1. "As you know, I am very concerned about the trade situation in this country. Do you think that trade implications would be better addressed if the forum for the MFJ were shifted to the FCC from the Court?"

Answer. The judgement court has taken potential positive effects on U.S. international trade into account when passing on specific waiver requests filed by certain of the Bell companies. At the same time, the judgment court has made clear its principal focus remains the antitrust and competition policy issues which arise under the AT&T consent decree.

As indicated in Assistant Secretary Sikes statement to the Committee regarding S. 2565, we believe international trade effects are a facet of the broad "public interest" standard under which the Federal Communications Commission (FCC) operates. We believe the FCC is better able to determine the trade and other consequences of proposed actions under the AT&T consent decree than is the district court functioning, as it does, primarily from an antitrust perspective.

Question 2. "What weight should trade considerations be given in determining whether, or under what conditions, the Bell Operating Companies should be permitted to enter new lines of business?"

Answer. Given the critical importance of this particular sector, we believe the trade consequences of proposed actions under the AT&T consent decree should be accorded great weight. As stated in Assistant Secretary Sikes' statement on S. 2565, however, we do not believe that the trade policy recommendations of the Executive branch should necessarily be determinative of the actions which the FCC may take.

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS

Question 1. "NTIA is now drafting a report on the common carrier industry. When will this report be completed?"

Answer. NTIA is updating the comprehensive report on domestic communications common carrier policies issued in July 1985. Issues including state regulation, local exchange market conditions, and trade are being addressed. We will complete this effort this fall.

Question 2. "The FCC does not have exclusive jurisdiction over the communications industry. Even if we do transfer jurisdiction of the Consent Decree to the FCC, what guarantees do we have that we will not find ourselves with new court oversight in the future?"

Answer. S. 2565 would not affect jurisdiction of the U.S. courts of appeals to review Federal Communications Commission (FCC) orders pursuant to section 402(a) of the Communications Act (47 U.S.C. §402(a)), the general jurisdiction of U.S. district courts to enforce FCC orders upon request of the Attorney General (47 U.S.C. §401), the applicability of state and Federal antitrust laws to the telecommunications industry, or state regulatory authorities. S. 2565, however, would significantly lessen the day-to-day involvement of the judgment court in the activities of AT&T and the Bell companies. Judicial oversight of FCC actions would continue, as it should, under this measure. The judgment court, however, would no longer be involved in what was referred to as "micromanagement" of the industry at the Committee's recent hearings.

Question 3. "Do you believe the RBOCs possess a bottleneck over local telephone facilities?"

Answer. The available evidence suggests that the Bell operating companies are still predominant suppliers of communications services within their franchise areas. It has been less than 22 months since the Bell System breakup and there are several reasons why major change would not have occurred in local exchange markets. The position of the Bell companies in those markets, however, is subject to qualifications.

Larger communications users have opportunities to use non-carrier supplied facilities to satisfy their needs. Surveys of large users indicate, for example, that between 16 to 29 percent of companies responding currently use alternative communications facilities that "bypass" local telephone company networks. Technological developments including "shared tenant services," moreover, make it more economical for smaller communications customers to use non-carrier supplied facilities, particularly to access interLATA long-distance networks.

Regulatory and technological changes have increased opportunities for new firms to provide local exchange services in competition with the Bell companies. Competition from cable television and digital termination systems has not grown as quickly as anticipated two years ago. Construction of private microwave (18-23 GHz), private local area networks, and commercial local fiber optic systems, however, is expanding. These alternatives may provide effective competition in certain lines of commerce to local exchange services offered by the Bell companies.

Question 4. "What safeguards are necessary to protect the ratepayer from cross-subsidizing the competitive ventures of the RBOCs?"

Answer. Safeguards include the adoption of improved accounting systems and controls, as well as continued state and Federal regulatory oversight of intracorporate transactions. The Federal Communications Commission (FCC) is developing improved cost allocation and accounting rules, in consultation with state agencies. When adopted, these rules should go far toward strengthening existing ratepayer protections provided for under present law.

Question 5. "What should be the role of the states in ensuring that ratepayers do not subsidize competitive ventures of the RBOCs? In ensuring that competitors of the RBOCs are not discriminated against?"

Answer. State agencies will continue to regulate the terms and conditions under which the Bell companies offer intrastate basic services. Through the tariff review process, state agencies can ensure rates are cost-justified and basic services are made available on reasonable, nondiscriminatory terms. As indicated in Assistant Secretary Sikes' statement on S. 2565, we would expect the FCC to continue working cooperatively with state agencies to minimize any possibility of anticompetitive conduct or ratepayer abuses.

Question 6. "Could you state specifically the trade benefits you envision from removal of restrictions on the RBOCs?"

Answer. We are now in the process of completing our assessment of the trade effects of the AT&T consent decree. When that assessment is completed, we will be in a better position to provide specific quantitative information than we are today.

The CHAIRMAN. Well, gentlemen, thank you very much for your testimony.

Let me try to explain the quandary that Congress is in. Clearly, this is a very important subject not only because it deals with a lot of businesses, large businesses, economic interests, but because it deals with the future of the country and its ability to perform well and competitively in areas where in the past we have excelled.

If you were to ask the Members of the Senate: "Do you think that the courts should continue to be exercising supervision, not even continuing jurisdiction as it is normally understood, but real supervision over the nuts and bolts of telecommuniations, do you think the courts should continue to be in that business?" The answer that I bet you 95 members of the Senate would give is "No," this is not something the court should be doing.

Do you believe that Congress should take upon itself what the court is now doing? Should Congress attempt to micromanage, as Mr. Ginsburg said, the business of telecommunications?

No, we are not managers. We are legislators. Do you believe that the responsibility should be transferred to a regulatory agency? Yes, we do so. And, the FCC is the obvious regulatory agency. I think that most people would say, just as a general principle, that this is where we should be going. I think most people as a general principle would say that Senator Dole is right on the money. Give it to the FCC.

Now, what is at stake here really is a specific example of a very broad question. What are the relative roles, what should be the relative roles of the three branches of government? It is just a very, very old question, and one that will be with us for a long time. You say, Chairman Fowler, that the regulatory agencies should undertake the management of telecommuncations policy subject to the oversight of Congress. That is the way the system is supposed to work.

But I think that the concern that is being expressed here is that once we turn this responsibility over to the FCC as a practical matter oversight does not mean very much, that the FCC is a very strong agency, that the chairman is a very strong chairman, an extraordinarily capable person, very, very bright, with a strong sense of direction. I compliment you, Chairman Fowler, but I think that the concern that people here have is that in this very important area, once we turn over responsibility, our role for all practical purposes is going to be over, and that is what we are concerned about.

What is the continuing role of Congress to be? Legislative veto? No, that has been held unconstitutional. In my mind it is good that it was held unconstitutional. I do not think that legislative veto is the appropriate role of Congress. What is the appropriate role of Congress? Is it to write detailed legislation in advance? Is it to set up a process for decisionmaking to be made by the regulatory agencies similar to the amendments that I suggested two weeks ago? Is that the appropriate role of Congress?

I think the concern is that if there is not specific direction or in lieu of specific direction, a specific process, then the FCC is a law unto itself, and I think the feeling, and I know Chairman Fowler will take umbrage at this, but it is my very strong feeling that the FCC is not exactly waiting for the phone to ring from Capitol Hill. I have to say that about the "must-carry" decision. I know we have talked about this, Mr. Chairman, and it is a difference of perception. But, my perception is that instead of the 14-page letter with 45 footnotes—and I cannot say that I wrote it, Dan Phythyon wrote it, but I thought that it was an extraordinary effort to advance thinking on the must carry subject—we may as well have sent you a note pad. I mean, you would not have had to turn it over and cut it up to use as scrap paper. You could have just used it, already made up for you.

My concern is that if all we were to say is let us pass the Dole bill, go to it, Mark, you would go to it. You say: Oh no, you have not prejudged, you have not prejudged any question. Maybe not. I am not questioning your sincerity in making that statement.

But I know Mark Fowler, and there is no question in this field that he has not thought about very carefully and does not have pretty clear ideas on. That is the problem that we have.

So Congress feels somehow we have to get into the fray, not just turn this over to the FCC, but somehow we ought to. We do not want to, and yet, we have to get into the fray. It is an election year, we do not like to make enemies, and there is no way to get into this fray without making a host of enemies.

Now, the proposals that I advanced a few weeks ago are process proposals. They are not substantive proposals. They just say that there should be a process for moving ahead in this area.

I do not know whether these are good ideas or not. First, Mark, let me ask you if you would like to respond to my diatribe. And then, my second question is what the response of this panel is to the amendment proposals that were unveiled on August 28th.

Mr. FOWLER. Well, first of all, Chairman Danforth, I am a little disappointed and I feel badly that you feel that, for example on must-carry——

The CHAIRMAN. You are not surprised, but you are disappointed.

Mr. FOWLER. No, I am surprised, and I am also disappointed, because I think that a large part of what we adopted came directly from proposals which you all made. The fact that the *New York Times* and the *Wall Street Journal* cited the Danforth proposals as being key components of the must-carry decision that we adopted, the fact that the Missouri State Broadcasters Association publicly praised you for your role in that, I think speaks volumes to the fact that we did use your letter for more than just scratch paper.

I have quite a bit of scratch paper myself and I do not need any more. I think we were very responsive in that respect. But we have had disagreements from time to time. We have also had areas where we have broadly agreed, and I think that the questions that you pose here are very good questions.

It is fair to say that I and other Commissioners do have a strong belief in letting go, that is in deregulating, where it can be done intelligently, and also letting in, that is, letting new competitors in to provide the people of our country with new choices.

And as I indicated a moment ago, if this issue is to be in part decided upon my stewardship at the Commission or the Commission's stewardship, I would argue that five and a half years of my record, with long distance rates down, as I said in my testimony, 22 percent in the last two and a half years, with local rates up 3.1 percent in 1985, with technological innovation of the highest order in this sector of our economy, probably the most dynamic sector, I am prepared to accept that kind of a judgment, and with international telecommunications fostering an information revolution worldwide for the good of all the peoples of the world.

But if there are concerns, if you do have, you think, potential problems with the way we might approach something, then I think the answer is very similar to what you have suggested in some of your proposed amendments, that is to provide the Commission with standards for decisionmaking or guidelines, whichever you would like to call them, that we should employ in reaching a substantive decision on some of the issues that are involved in a transfer of the consent decree provisions to the FCC under the Dole bill.

That way, through oversight and indeed through court action on the part of the parties appearing before the Commission, that statutory language does have meaning in law. It has to be complied with, and I believe that is the way you can assure yourself that the Commission will carry out the dictates and mandate of the Congress, as indeed I believe we have done faithfully over five and a half years.

I appreciate your concerns, and I think we need to have lunch, frankly, because I would like to talk to you a little more.

The CHAIRMAN. Well, I do not think you are surprised at my comments. I have shared them with you before, especially on the must-carry subject.

Your response to the second question, is that the August 28th proposals seem to be going in the right direction?

Mr. FOWLER. I think that there are some that clearly are guidelines. For example, the concern about making sure that ratepayers are afforded protection from subsidizing, in any way, competitive activities, making sure that there are indeed, provisions made to assure non-discriminatory access to the local exchange network by competitors of a Bell operating company operating in a new competitive area, taking into account the trade concerns that Secretary Sikes mentioned, national security implications, the competitive position of the United States, and technological innovation in the United States.

The CHAIRMAN. These are areas where you would anticipate the FCC would not say to the operating companies, "let 'er rip," right? Your view is that the FCC would take the position, if it had jurisdiction, that some restraint should be imposed in these areas?

Mr. FOWLER. Based on the present situation—and I would want to see a full record developed—absolutely, Chairman Danforth. There is no question.

The CHAIRMAN. In the area of cross-subsidy, that would be one example?

Mr. FOWLER. Yes, sir.

The CHAIRMAN. In the area of not permitting the operating companies to be so integrated that they provide bottlenecks to competition for lang distance, that would be an area where you would see restraints being maintained?

Mr. FOWLER. Absolutely. In fact, that has been the record where we have dealt with these very same kinds of issues, for example, permitting the Bell operating companies to provide customer premises equipment. We had some of the identical issues involved that are involved in some of these other issues, and we used regulatory power and mechanisms to make sure that if they entered into the provision of CPE in these equipment markets, that it would be done in a fair way.

I believe that what has happened so far bears that out. They have not dominated the CPE market by any stretch of the imagination. They face some very formidable competition, in fact some competitors who are far larger than they are. And we designed mechanisms to make sure that ratepayers do not subsidize that activity and that they cannot discriminate against their competitors through the adverse use of their monopoly facilities.

So we have a record already dealing with issues very similar to these. But I think that the kinds of guidelines that you are talking about, the ones that I mentioned among others, are very, very useful and I think good policy. And we welcome your direction.

We do not in any way believe that we are anything other than a creature of Congress.

The CHAIRMAN. If other agencies such as the Commerce Department were given roles to play with respect to say international competition, do you think that their role should be one of just advice or should it be a role of being able to participate in the decisionmaking?

Mr. FOWLER. That would be a matter for you all to consider, Mr. Chairman. I think that at the least it should be a requirement that we would have to consult and seek their expert opinion on the issues that you specify.

The CHAIRMAN. Would that be a scrap paper manufacturing operation?

Mr. FOWLER. Again, I think that that is unfair, for the reasons that I indicated a minute ago. The Missouri Broadcasters again I think probably would be my exhibit on that.

But no, it would not be a scrap paper exercise by any stretch of the imagination. And again, I think that we would sometimes make some people unhappy who come to you, as Congressman Tauke indicated and Senator Pressler, when we are dealing with issues involving potential competitors, and they are very, very unhappy.

I do approach the question of these bans that are now in place, and I find them as a general matter to be things that need to be examined, and I have said that. Now, if that is a predisposition, as some would characterize that, there is a predisposition, yes, to want to look at flat bans to permitting companies to enter markets.

But the terms and conditions upon which that entry occurs and the timing are questions that, we have not made any judgments on and have no record on.

The CHAIRMAN. Let me just give you a hypothetical. Let us suppose that there is a piece of equipment that is widely used and that is manufactured by a Western Electric, and it is manufactured exclusively in the United States. And let us supposed that a Bell operating company were to come to the FCC and say: Look, we want to get into the business of manufacturing this.

And you say: Well, where do you want to do it? And they say: Well, we've got a plant all ready to go. We know exactly where it is; it is in Taiwan, and we believe that they can make just the right kind of equipment. You ask the USTR or the Commerce Department or somebody: What is the trade implication?

And they say: This is devastating; this is a very key thing for us and it is a major aspect of American technology, and it is really threatened. So our advice would be to not go forward.

Do you have any sense of how you would handle that kind of problem?

Mr. FOWLER. I do not have any sense of that, because I would want, Chairman, to develop a full record on that question, that is, I would want to know what other agencies say on that issue, if it has an impact on them, and to consider the public interest considerations that go along with that.

The CHAIRMAN. Let us suppose that it is a typical trade-type question. That is, it is clear that the manufacturing will occur abroad, that there will be a cost saving in it, and that is the nature of the evidence; and that it is clear evidence, not equivocal.

Mr. FOWLER. I would not want to judge that until I had a full record. I am not trying to duck the question, but these are the very kinds of issues that are complex. Nevertheless, Senator, your suggestion that you would promulgate standards for those decisions to be made under is something that I would support, and in that way the Congress, through these broad guidelines, could achieve the degree of control that I believe you desire the Congress have.

The CHAIRMAN. Right. But if the idea is not for us to micromanage the process or make specific decisions in advance, but simply set out some criteria or some standards, obviously this is going to provide a lot of room for interpretation by the FCC.

And if the interpretation is always going to be, well, that is very interesting, we can weigh international competitiveness, but the basic need is to make sure that the Bell operating companies can do whatever they want or manufacture equipment and there are some lower costs that are made possible as a result of that, I mean, if that is going to be the predisposition of the FCC, any criteria other than extremely specific, enforceable criteria are going to be worthless.

In other words, if you cannot go to court and get an order against the FCC on a non-discretionary matter, if there is any discretion left, then no matter how we might put hortatory language in the statute you are going to be free. And I think that that is the concern that is being expressed here.

Mr. FOWLER. Senator, I think this: I think you have several choices. One is that you can abolish the FCC and have a staff in the Congress do this exclusively. In other words, take the jurisdiction away from the FCC. No one, I believe, thinks that that is a feasible option.

Another is to micromanage through statutory means what the Commission should do on each issue, which sounds a lot similar to the first option and I do not think that is feasible, either. But it is possible.

Another option is to provide us with broad guidelines and see what the Commission does subject to Congressional oversight and subject to court enforcement concerning specific decisions we make.

Now, none of those from your standpoint, I would gather, based on what you have said this morning, are very palatable options.

The CHAIRMAN. I favor the third, just philosophically. I would like to get back into the letter-writing business. I think the reason why this is such a quandary for members of the Congress is that we are wondering what the relationship is between the FCC and the Congress, and we are wondering, if we do just provide general guidelines, unless it is very specific and no discretion is left with the FCC, what is going to be left.

Mr. FOWLER. Mr. Chairman, I think we have been very responsive. And I would also point out, with all due respect, that I was, after all, appointed by President Reagan, and the President has a certain way of looking at the world as well, and I have to also honor that philosophy.

So there is always room and possibilities for disagreements. The question is, how do we work them out. That does not mean we always can work them out, but I would just observe that you have the ultimate power to order the Commission to do what you think we should do if we are doing that which you think we should not be doing.

The CHAIRMAN. Mr. Ginsburg, Mr. Sikes, do you have any comments on this monologue that turned into a dialogue? Would you like to get into the fray?

Mr. GINSBURG. Well, Senator, in response to your initial question about whether the appropriate Congressional role here is one of legislating in detail in advance or spelling out a process, I think it is reasonably clear that the drawbacks to legislating in detail in advance are very significant.

But it is important, I think, to try, in giving the kind of guidance that you and the Chairman have been discussing, to do so in a way that does not inadvertently spill over into prescribing particular outcomes or even particular procedures unless they are demonstratably necessary.

I would contrast, among the possible amendments that you have raised, on the one hand, the proposal for consultation with executive branch agencies on matters within their relevant expertise and, on the other hand, a prescription that a particular type of auditing requirement be imposed on the Bell operating companies and their holding companies in anticipation that there will be need for that kind of potentially very cumbersome and costly procedure beyond the Uniform System of Accounts that the FCC is already imposing.

I think an attentiveness to avoiding unnecessary prescription and giving the kind of guidance you have been discussing would be sufficient here to assure the appropriate role for Congress.

Let me just add, as someone who shares your perspective in the sense of coming to this topic with ambitions for policy outcomes and aspirations which are never completely achieved, I think all of us in these positions are much more acutely aware of the attempts that do not succeed than of those that do.

I think this committee and its counterpart in the House have been extraordinarily successful in the oversight process with respect to the FCC over the last decades. These committees have provided the textbook example of the way in which Congressional oversight has worked, through hearings, through informal action, as well as through discussion of legislative proposals.

The CHAIRMAN. Mr. Sikes?

Mr. SIKES. Well, I have been at this job for five months, and there is one thing that is crystal-clear to me and that is that this is an extraordinarily fluid environment. Competition factors, factors of technology, factors that occur offshore over which we have no control, make this an extraordinarily dynamic field of enterprise. I think that for philosophical reasons, which I would agree with you on, that general oversight or general criteria or general standards are far superior to a specific detailed sort of prescriptions.

You know, beyond that general philosophical agreement, I think this is the sort of dynamic environment within which that sort of detailed legislative directives would abort and have grave, grave consequences.

The CHAIRMAN. Senator Gorton.

Senator GORTON. Mr. Chairman, there is for all practical purposes nothing I can add to your comments, with which I have a strong degree of agreement. Your suggestions really do go in the direction of the fourth of my outlines of possible courses of action before the committee.

I also agree with you that—I think I heard you say—that it may be in some of these areas that we are going to have to deal with matters of substance, as well as matters of procedure, if we wish the policies we deem correct to be followed by the Communications Commission.

I would only say that your suggestions and others' suggestions of this sort in my view require not two weeks, but six to twelve months, of serious consideration.

The CHAIRMAN. Senator Exon.

Senator EXON. Mr. Chairman, thank you very much.

My first question would be to you, Mr. Sikes. I notice in your testimony you say: "We believe prompt enactment of this proposed legislation is essential." What do you mean by "prompt enactment"?

You do not anticipate that action is going to be taken on this proposition for the rest of this calendar year, do you?

Mr. SIKES. I would simply share the hope that Senator Dole expressed at the outset of the hearing when he expressed just that hope, that the action could be completed in this Congress.

Senator EXON. I am not the Majority Leader and obviously the Majority Leader has much more do to with this than one individual Senator from Nebraska. But I find no one, with the possible exception of the Majority Leader, who believes that there is any chance whatsoever that a bill could not only pass the Senate, but pass the House of Representatives, during the extreme time constraints that we have.

Now, unless we want to give up that recess period between October 3rd and the November elections, which I suspect, if history is any indicator at all, that that is not likely to happen. So I think it is wise if we put this in the proper context, at least as far as this Senator is concerned.

And I would feel that, while this hearing is very important because it sets the stage for something that has to be addressed, I do not believe that there is any chance of prompt enactment of this legislation, essential or otherwise, in 1986.

Chairman Fowler, I would like to turn to you, and I want to compliment you for packing the hearing room today. This is the largest crowd that I have seen in the hearing room since our famed or ill-famed hearing or video rock music. So you have exceeded or excelled even Twisted Sister, and I compliment you for your notoriety.

Let me ask a serious question. There are concerns of those of us that represent especially rural America, including many members of this committee and I suspect the two other Senators currently present included in that group, that we basically feel that, while deregulation by and large has been described as successful in the airline industry and in the telecommunications industry, there is a general concern rural America's interests have not been served, certainly with the airline deregulation.

And we have grave concerns about what that might do likewise in the telecommunications industry. Basically, what I am harping on once again is that one telephone in that one house in that one rural area of Nebraska, and other sections of the country have similar situations.

If this bill that the majority leader has advanced were to become law, that would certainly place new responsibilities in the hands of your Commission. And there are, frankly, some of us that feel—I do not want to be critical, but there are some of us who feel that the Commission has been less than interested in—maybe that is an unfortunate choice of words, but I will still say it—less than totally interested in what this type of legislation might do as interpreted by you and the Commission as it presently exists.

Can you allay my fears in that area and tell me whether or not you think they are justified? And if there is a concern, how do you feel that might be addressed by the Commission?

Mr. FOWLER. I have heard that concern before, Senator, and I would respond this way.

First of all, you touched on the rural point. Unlike some of the deregulatory initiatives in other sectors of the economy, one thing that the Commission did early on was to establish a universal service fund where so much per minute is taken and charged to long distance rates and put into this kitty, which amounts to about $500 million, half a billion dollars. That is then taken and targeted to rural high cost telephone companies precisely to keep local rates down.

Now, that is something that we did at the Commission and that I supported. The Congress was concerned about rural users and their rates, and it is an example of being sensitive to rural needs and to Congressional concerns.

That program, by the way, Senator, has worked very, very well. I know you have a great concern because much of your state, in fact, a great deal of your state, is rural. That fund is designed to specifically hold down local telephone rates, and it has worked and worked very, very well. We will continue that program. It is a really good program.

Now, as I indicated earlier, any concerns that members of Congress have about how well the Commission would follow its desires and wishes in implementing S. 2565 and in looking at the issues that implicitly would be presented to us, should the Dole bill with possible amendments be passed, I would suggest that the guidelines, among which there are several that Senator Danforth has proposed, that would give us standards for decisionmaking on these issues would be a very good way to start. That would give you some assurance that the Commission would be moving in a way that the Congress desired.

I think that that is the way you can solve that problem.

Senator EXON. Thank you. Thank you, members of the panel, and thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, thank you very much for your testimony.

(Whereupon, at 11:37 a.m. the meeting was adjourned.)

FEDERAL TELECOMMUNICATIONS POLICY ACT OF 1986

TUESDAY, SEPTEMBER 16, 1986

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to notice, at 9:33 a.m. in Room SD-253, Dirksen Senate Office Building, Hon. John C. Danforth [Chairman of the Committee] presiding.

The CHAIRMAN. This is the second day of hearings on S. 2565, the Federal Telecommunications Policy Act of 1986. We have four panels today.

The first panel is Edward C. Schmults, Senior Vice President, GTE Corporation; and Charles Marshall, Vice Chairman of AT&T.

Gentlemen, if you would step forward.

Senator FORD. You thought you were alone.

The CHAIRMAN. I am delighted to announce that Senator Ford has a statement.

OPENING STATEMENT BY SENATOR FORD

Senator FORD. The Committee is so crowded this morning, Mr. Chairman, you thought you were alone. I am very pleased to see the great interest that is displayed in this legislation, and I appreciate the opportunity to make a comment.

I am sorry that I was unable to attend the last hearing on this subject but, as usual, we have conflicting sessions and we had a markup in the Energy Committee when I could not be here.

I understand I missed some interesting questions by the Chairman, and since I do share some of his concerns with the regulatory actions in the telecommunications area I am sorry I was not here, Mr. Chairman, to listen to your interrogation.

I want to compliment the Chairman for calling these hearings. Although there is little time left in this Congress, I do believe that the Congress looking at this issue is a very positive step. It seems that Congress has not reacted to matters in the telecommunications arena and has sit back and let other branches of the government develop policy when it, in my opinion, is the responsibility of Congress to develop the policy and the other branches to carry out that policy.

I think it is time that Congress completely reviewed telecommunications and makes a policy statement which will guide the rapidly developing telecommunications industry through the next decade. It is obvious, Mr. Chairman, that there are many players in this area, but it is the responsibility of the Congress to assure all citizens that they will receive the benefits of the new technology at the lowest possible price.

My observation, Mr. Chairman, is that most of those in the business today that are in competition for the major business are for large corporations or for large dollar volumes. It bothers me some, and it is worrisome that those residential users may be left out in the scramble for the major integral part of the business.

I think we ought to at least take the opportunity to look at what the various "Baby Bell's" now as they are called in other areas have an opportunity to be involved in the direction of the next decade of the telecommunications arena.

So, Mr. Chairman, I look forward to the hearings today. I look forward to the statements, and I appreciate the opportunity that you have given me to say a few words.

The CHAIRMAN. Thank you, Senator Ford.

Mr. Schmults.

STATEMENTS OF EDWARD C. SCHMULTS, SENIOR VICE PRESIDENT/EXTERNAL AFFAIRS AND GENERAL COUNSEL, GTE CORP.; AND CHARLES MARSHALL, VICE CHAIRMAN OF THE BOARD, AT&T

Mr. SCHMULTS. Thank you, Mr. Chairman.

I am pleased to be here today to represent GTE Corporation. When I say I am pleased to be here, I really mean it. The last chair I sat in about a half hour ago was my dentist's chair, so I am glad to be in this chair. I am sure it will be less painful.

I understand my long-form testimony will be printed in the record.

The CHAIRMAN. All statements are automatically in the record if the witnesses summarize and hopefully within the allotted time requirement, it would be appreciated.

Mr. SCHMULTS. I will certainly summarize within the allotted time.

GTE supports S. 2565, the Federal Telecommunications Policy Act of 1986, as introduced. We believe that the central goal of the bill to consolidate for the most part Federal telecommunications policymaking in the agency specifically created by Congress for that purpose is a wise decision.

In GTE's view, the administration of the Consent Decrees has really had the unintended effect of transforming a Federal District Court and the Department of Justice into a parallel layer of telecommunications regulators.

I think it is fair to say that neither the Department nor the court really possesses the resources, the experience, or the expertise found at the FCC. I make this point with the greatest respect for the highly professional and diligent work of the Antitrust Division and Judge Greene in administering the Decrees.

The decisions made under the Consent Decrees, and obviously decisions to be made, are so fundamental to the future of telecommunications in the United States that GTE believes that the FCC is where these decisions ought to be made. In making those decisions under the Communications Act of 1934, the FCC as we know will be applying a broad public interest standard which is considerably broader than the antitrust concerns of the Department of Justice and the Federal District Court.

In that process, the FCC can take into account a wide range of national interests, including those of consumers, subscribers, state commissions, industry participants, other Federal agencies, as well as the Congress itself.

In my view, a very important point to note is that the passage of S. 2565 would also restore effective congressional oversight of Federal telecommunications policymaking. Again I think it is fair to say that this Committee really has no effective oversight responsibilities—or ways of carrying out oversight—over a Federal District Court or, for that matter, the Antitrust Division of the Department of Justice.

So we think it is significant if the FCC is the place where the responsibilities under the Consent Decree are lodged that this Committee and its counterpart in the House can effectively exercise its oversight, and of course can change or seek to have the Congress change whatever the FCC does if it is not to the liking of Congress.

In transferring the Consent Decrees we urge that this Committee not change the basic framework of the Decrees as they were negotiated by the Department of Justice and approved by Judge Greene. We also urge that you not restrict the exercise of the FCC's normal discretion under the Communications Act.

So far as changing the basic Decree framework, our GTE Consent Decree as negotiated reflected the differences between GTE and the old Bell System. The restrictions are quite different in each decree. As I said, they were negotiated by the Department of Justice and they were approved by Judge Greene, and it is very important to us as a company that the basic framework of our Decree not be changed.

I think the proponents of amendments that would restrict the FCC's normal discretion under the Communications Act are really prejudging what the Commission will do in the future if it obtains responsibility for administering the Consent Decrees. In our view, any legislatively imposed restrictions could well be outdated in as little as six months from now. I think one thing is clear, and that is the rapid change which characterizes the competitive environment and the pace of technology which in turn really make it important that government responses be flexible and tailored to then-current conditions.

That really is the genius of the administrative process. That is why Congress created administrative agencies. So we are concerned that any legislatively imposed restrictions might prove to be unworkable and would require this Committee to revisit the problems time and time again.

So we urge this Committee, Mr. Chairman, to report out S. 2565 in essentially its current form. Thank you very much.

[The statement follows:]

STATEMENT OF EDWARD C. SCHMULTS, SENIOR VICE PRESIDENT, EXTERNAL AFFAIRS AND GENERAL COUNSEL, GTE CORP.

Mr. Chairman and members of the Committee, thank you for allowing GTE Corporation to participate in this timely and important hearing on S. 2565, the "Federal Telecommunications Policy Act of 1986."

GTE owns 15 domestic telephone operating companies which operate in 31 states. In addition, GTE companies provide many unregulated or lightly regulated telecommunications services, such as cellular mobile. GTE also develops, manufactures, and markets telecommunications systems and equipment, as well as Sylvania lighting products and precision materials. Through a joint venture called U.S. Sprint, which is equally owned with United Telecommunications, GTE has an interest in the long distance business provided by what was GTE Sprint and U.S. Telecom, and a packet switching business provided by what was GTE Telenet and U.S. Telecom Data Communications. GTE employs over 130,000 persons in the United States, and about 40,000 abroad.

GTE supports S. 2565 and its goal of transferring administration of the matters covered by the Bell and GTE Consent Decrees to the Federal Communications Commission.

We believe that federal responsibility for national telecommunications policy has become too fragmented since the Bell System divestiture, and that it should be centralized in the FCC. The FCC has the mandate, expertise, and resources for the task, provides a forum for broad public comment, and is subject to continuing Congressional oversight. Moreover, as the telecommunications industry moves toward further deregulation and competition, having federal policymaking, for the most part, in one expert agency should facilitate a more orderly transition towards these desirable goals.

It was necessary in settling the antitrust charges for the Consent Decrees to be negotiated by the Justice Department, and entered by the federal district court under the Tunney Act requirements. Nevertheless, repeated requests under the Bell Decree for waivers and the Decree interpretation process have transformed the court and the Department into a parallel layer of telecommunications regulators. Neither possesses the resources, experience or expertise found at the FCC. I make this point with the greatest respect for the highly professional and diligent work of the Antitrust Division and Judge Greene in administering the Consent Decrees.

The complexity and national importance of administering these Consent Decrees cannot be compared to the ordinary consent decrees between the government and private parties settling antitrust charges. The administration of these Decrees will continue to have a significant and pervasive effect on the telecommunications sector of our economy. Indeed, they already have had a pervasive effect on every telephone user in the country.

It is because the decisions made under the Consent Decrees are so fundamental to the future of telecommunications in the United States that GTE believes that they should be made by the FCC—the expert agency created by Congress to oversee telecommunications. In applying the public interest standard in the Communications Act of 1934, which is broader than the antitrust concerns of the Justice Department and the court, the FCC can consider and weigh a wide range of interests, including those of consumers, subscribers, state commissions, industry participants, and other federal agencies—not to mention Congress itself.

From GTE's standpoint, S. 2565 as introduced preserves the significant differences incorporated in the GTE and Bell Consent Decrees between GTE and its telephone operating companies (Class II Companies) and the regional Bell and Bell operating companies (Class I Companies). These significant differences were recognized by the Justice Department in negotiating the GTE Decree and were accepted by Judge Greene when he approved it, in each case after extensive review.

The event which gave rise to GTE's Consent Decree was our company's proposed acquisition of a long distance carrier—Sprint—from Southern Pacific in 1983. In July 1986, as I have noted, Sprint became a part of the U.S. Sprint joint venture partnership equally owned by GTE and United.

The Justice Department was prepared to challenge GTE's 1983 acquisition unless GTE agreed to maintain a separation between its telephone companies and the long distance business to be acquired. This separation requirement was designed to prevent cross-subsidization and discrimination. As part of that Decree, GTE's telephone companies also agreed to provide equal access to all long distance carriers, and not to provide interexchange services in the United States.

Prior to this acquisition, GTE had not been in the long distance telephone business except as part of its local company and satellite participation in the national public switched telephone network.

All of this was in marked contrast to the Bell System which included local telephone companies owned and controlled by AT&T as the dominant nationwide (and worldwide) long distance carrier. In the AT&T antitrust case, the Justice Department, after a long trial, accepted nothing short of divestiture—that is, the splitup of the long distance business from the local Bell companies—and the imposition of a number of significant restraints on the local Bell companies.

Those Bell companies and their parent regional holding companies are permitted under the Bell Consent Decree to provide only exchange, exchange access and regulated monopoly services, telephone directories, and customer premises equipment which they cannot manufacture. Also, they are prohibited from providing interexchange and information services.

By contrast, under its Consent Decree GTE's telephone companies can provide any service anywhere, so long as (a) it is not an interexchange service, and (b) if it is an information service, it is provided by separate entities and consistent with other Decree separation conditions. Thus, our telephone companies have no "line of business" restrictions as do the Bell companies. GTE's non-telephone company components may provide interexchange or any other service or product.

As I have indicated, GTE's Consent Decree restrictions, as agreed to by the Department of Justice and as approved by Judge Greene, reflect the significant historical business differences between GTE and the old Bell System. The principal differences were:

1. *Differences in size between AT&T prior to divestiture and GTE.*—AT&T dominated every aspect of the telecommunications industry, and also provided local telephone service to over eighty percent of the nation's telephones. By contrast, GTE's telephone companies provide service to only about eight percent of the nation's telephones;

2. *Local exchange concentration.*—The Bell companies were dominant almost everywhere. GTE's telephone companies are relatively thinly dispersed over 31 states serving roughly half as many telephones per square mile as the Bell companies do. Also, the Bell companies serve the vast majority of high-density, heavily populated metropolitan areas while GTE's telephone companies serve primarily the nation's rural and suburban areas; and

3. *History of Bell System Integration.*—AT&T, when vertically integrated for more than a century, served every Bell company area. Sprint had no such prior relationship with GTE's telephone companies. (As indicated earlier, with the creation of the U.S. Sprint joint venture between GTE and United, GTE's interest in Sprint's successor is a fifty percent partnership interest.)

I have briefly described the reasons for the significant differences between the Bell and GTE Consent Decrees because this background is essential in considering the structure of S. 2565. I cannot emphasize strongly enough how important it is to GTE that S. 2565 continue to preserve these differences. Transferring responsibility for prospectively administering the subject matter of our Consent Decree is in the public interest. Rewriting the basic terms of the Decree hammered out more than two years ago in negotiations with the Executive Branch and approved by the Judicial Branch is quite another matter and, in GTE's view, not justifiable. Thus, we urge the Committee not to amend S. 2565 in any way which would change the Decree framework.

Turning now to the question of whether S. 2565 should be amended to provide more direction to the FCC, GTE's recommendation to this Committee is "no." In considering this question, we believe it is important to note that one of the most significant benefits of the transfer of Decree subject matter administration to the FCC is the restoration of Congressional oversight over telecommunications policy matters. In the currently fragmented telecommunications policymaking environment, effective Congressional oversight has been frustrated because this Committee and its counterpart in the House have no oversight responsibility for the federal courts or the Antitrust Division of the Justice Department.

You have heard and will hear some criticism of a pure subject matter transfer which is what GTE is recommending. Amendments have been discussed which would restrict the FCC's administrative discretion and would impose additional restrictions on the Bell companies. Mr. Chairman, you have addressed the concerns of those advancing these amendments by asking the witnesses to comment on certain proposals. It seems to GTE that the proponents of such amendments may be prejudging or even just guessing what the FCC will do in administering the Consent

Decrees. We see no reason to engage in such prejudging or guessing. There will be time enough for Congress to act if it does not like what the FCC does.

As we all know, the telecommunications industry, the technology on which it is based, and the national environment in which its participants operate are rapidly changing. Thus, any restrictive legislative rules for the FCC adopted by the Congress today may well be outdated even six months from now. The probable result would be that this Committee would be compelled to regularly revisit the legislatively imposed restrictions. We believe that any new standards or requirements at this time limiting the exercise of FCC expertise would diminish or defeat the advantages of a flexible and responsive administrative process.

As stated before, Congress and this Committee can more than adequately monitor developments in telecommunications policymaking through the restoration of the oversight role which would be achieved by the enactment of S. 2565.

For these reasons, we do not believe that any amendment to S. 2565 is desirable or necessary.

To conclude overall, GTE fully supports the legislative proposal, embodied in S. 2565, to transfer administration of the subject matter of the Bell and GTE Consent Decrees to the FCC, without any substantive changes in such Decrees and without legislative restrictions on the FCC's normal administrative discretion under the Communications Act of 1934. We urge this Committee to report out S. 2565 in essentially its current form.

[The following information was subsequently received for the record:]

GTE Corp.
Stamford, CT, September 23, 1986.

Hon. John C. Danforth,
Chairman, Committee on Commerce, Science and Transportation, U.S. Senate, Hart Senate Office Building, Washington, DC.

Dear Senator Danforth: This letter contains GTE's response to the two questions posed to it following my testimony before the Commerce Committee last week. It also contains a suggested technical change to ensure that S. 2565 is fully consistent with the GTE Decree negotiated with the Justice Department and approved by Judge Greene.

The first question asks whether the differences between the AT&T and GTE Decrees are justified. As I indicated in my testimony, they are.

As I pointed out on pages three to six of my testimony in more detail, the differences in the restrictions reflect the significant historical business differences between GTE and the integrated Bell System. AT&T dominated every aspect of the telecommunications industry while, by contrast, GTE's telephone companies provide service to only about eight percent of the nation's telephones. In addition, the Bell companies evidence a much greater concentration of local exchange service than the GTE companies.

Also, AT&T was vertically integrated for over a century and served every Bell territory. Sprint had no such prior relationship with the GTE telephone companies.

With regard to this question, we believe it is significant that these differences were recognized by the Justice Department in negotiating the GTE Decree and were accepted by Judge Greene when he approved it, in each case after extensive review.

You have also asked whether GTE would support S. 2565 if it were amended to add safeguards for competition and ratepayers, and whether GTE could support amendments along the lines of your proposals.

If competition and ratepayer safeguards were in the form of general directions to the FCC to take these factors into account, GTE could continue to support the bill. However, if amendments were added to S. 2565 which would materially restrict FCC discretion in administering the Decrees GTE would have to reconsider its position.

One additional matter is that in our review of S. 2565, we have discovered one significant area in which the bill would change the GTE Decree. We are sure this was inadvertent and request that it be amended. Attached is an identification of that area, and suggested technical changes which would correct it.

As the Commerce Committee continues its deliberations on these important matters, GTE stands ready to respond to any further questions and to assist in any other way it can. Thank you for the opportunity to participate in this process.

Very truly yours,

Edward C. Schmults,
Vice President and General Counsel.

The CHAIRMAN. Thank you very much, Mr. Schmults.

Mr. Marshall.

Mr. MARSHALL. Thank you, Mr. Chairman.

Mr. Chairman and Members of the Committee, my name is Charles Marshall. I am Vice Chairman of the Board of AT&T. I appreciate very much this Committee's invitation to appear today during your consideration of Senate Bill 2565, the various proposed amendments, and the related issues and questions.

While I have filed a more complete statement with the Committee, Mr. Chairman, I can give you the gist of our position very briefly.

Because while the issues addressed by S. 2565 and the questions you have raised, Senator Danforth, are very complex, our views can be put very simply: Congressional consideration of this proposal at this time is premature. At this time, no one has the benefit of facts being developed in two studies that will be crucial to any informed consideration of the critical issues, and more facts will be available in January of 1987 in just two-and-a-half months.

One study is being conducted by the Justice Department. A second is being conducted under the auspices of the National Telecommunications Information Administration. Both of these studies are gathering facts on the industry, and they examine the appropriateness for continuing any or all of the business restrictions imposed by the Consent Decree.

We also expect the Department of Justice to make a recommendation to the court which may well result in changes to the Decree itself. As we understand it, the principal significance of the proposed legislation will be that the FCC not the courts would have the authority to relieve the divested telephone companies of the line-of-business restrictions imposed by the Decree.

The bill would also change the standard of review from an antitrust to a regulatory standard. As this Committee knows, the central premise of the Decree and the rationale for these restrictions was the fact that the local telephone exchanges were monopolies. Everyone recognized, including the court, that at some point changes in technology or changes in the structure of the marketplace could mean an end to the local monopoly and thus eliminate the need for the restrictions on interexchange services, information services, equipment manufacturing, or the current waiver process.

We believe it is critical as a threshold for consideration of these issues to know what the characteristics of the local exchange are today. Does the monopoly persist, or have conditions changed? The Department of Justice study is examining that. Moreover, the NTIA study will add other dimensions to our knowledge, including the impact of the restrictions on international trade, employment in the industry, and other related subjects.

In short, in four months' time the court, as well as the Congress, will have the report of Justice. It will have access to the NTIA material, and will consider what modifications make sense given the changes and the experience since 1/1/84.

Our position is based on common sense. Common sense prompts these questions: Why move now before the facts are in? Why start tampering now with something that was nearly a decade in the making, and is only two-and-a-half years old, particularly since we will soon have a factual assessment of the implications?

Why move now when it appears that the public is beginning to recover from the wrenching changes it experienced, when it is beginning to see local rates stabilize and long-distance rates drop, when the telephone companies are flourishing and competition in key parts of this industry is yielding benefits to the consumers?

To start churning things up again without evidence that changes are or are not warranted, and when such evidence is in near prospect, creates in our view unnecessary uncertainties once again for the public, to say nothing for this industry.

Consideration of this proposal, I would respectfully submit, is one issue that would benefit by a little restraint, a little time-taking. The Congress will certainly have better information available to it, and then the issue can be given the deliberate and full consideration that it surely deserves.

Thank you, Mr. Chairman, and Members of this Committee. I will be happy to answer any questions.

[The statement follows:]

STATEMENT OF CHARLES MARSHALL ON BEHALF OF AT&T

Mr. Chairman and Members of the Committee: my name is Charles Marshall. I am Vice Chairman of the Board of AT&T. We greatly appreciate the Committee's invitation to appear today to discuss S. 2565 and the wide range of proposed amendments and other issues that Chairman Danforth has raised.

S. 2565 is intended to transfer the authority to administer, enforce, and modify the AT&T and GTE Antitrust Consent Decrees from the federal courts to the FCC. Its principal significance would be that the FCC, not the courts, would have the effective authority to relieve the divested Bell Operating Companies ("BOCs") of all or some of the injunctive requirements that the AT&T Decree ("the Decree") imposes on those companies.

Chairman Danforth's proposals and questions address a number of competitive, ratepayer, industry structure, trade, antitrust, technological and labor issues. This list of issues includes the very questions that the FCC, the Justice Department, the Congress and other agencies grappled with for the decade that preceded the entry of the Decree—without any resolution—and represents the very quagmire that the Decree sought to end.

AT&T believes that the commitment of public and private resources necessary for Congressional consideration of these highly complex issues at this time is premature and inappropriate. The overriding fact is that the Justice Department and the National Telecommunications and Information Administration (NTIA) are now conducting extensive factual investigations into whether conditions have changed over the three years since divestiture so that any or all of the restrictions should be vacated or modified. These factual investigations encompass many of the same questions that have been raised before this Committee. These uncompleted factual studies also will form the basis for a recommendation that the Justice Department will file with the Court this January and will lead to a decision early next year on whether and how to modify the substantive requirements of the Decree.

Until the factual review by the Executive branch is completed, until the DOJ makes its recommendations known, and until the Court has the opportunity to act, there is no basis for legislative consideration of these issues. What record there is on these issues in this Congress is long on questions and short on answers. Rushing to judgment now would serve no purpose other than, again, to disrupt a telecommunications industry that, above all else, needs a period of relative stability.

My testimony will (1) explain the antitrust and regulatory background for the Decree and its line of business restrictions; (2) describe the post-divestiture administration of the Decree and (3) discuss the pending proceedings to reassess the line of business restrictions and why any legislative attempt to change the Decree now is premature and likely harmful.

I. ANTITRUST BACKGROUND OF THE LINE OF BUSINESS RESTRICTIONS

AT&T's divestiture of the BOCs on January 1, 1984, and the line of business restrictions on them, are both essential features of an antitrust remedy that sought to put an end to decades of incessant antitrust and regulatory controversies. Indeed, the divestiture and the restrictions are merely different sides of a single coin. Each stems from a fact that has now been recognized by Judges ranging from Judges Buckley, to Scalia, and Mikva on the D.C. Circuit, to District Judge Harold Greene, to the United States Supreme Court: the BOCs' local exchange facilities are natural monopolies or "bottlenecks," and it creates profound competitive controversies—and intractable regulatory disputes—if a single firm both owns these monopoly facilities throughout a wide region and participates in the closely related competitive businesses that depend on "access" to them.

Prior to 1984, the Bell System had been in precisely this position. Through the BOCs, the Bell System owned the local telephone exchanges, which everyone recognized were natural monopolies that competitors could not duplicate. Through AT&T and Western Electric, the Bell System also participated in three competitive businesses which depended on access to the BOCs' local "bottlenecks" or information controlled by them. The Bell System provided interexchange (long distance) telephone services, which require use of BOC local exchange facilities to originate and terminate each call. It provided a very few information services, which similarly require access to local telephone facilities. Finally, it engaged extensively in telecommunications equipment manufacturing, which requires access to information about the evolving technical characteristics of the local exchanges and allegedly permitted AT&T an unfair headstart in design and development, created opportunities to cross-subsidize manufacturing costs with ratepayer revenues, and gave the BOCs incentives to favor their own affiliated manufacturer in making procurement decisions.

This combination of local bottleneck monopolies and the related competitive businesses led to constant debate, turmoil, and uncertainty. The allegation was that the Bell System would "leverage" its exchange monopolies to prevent or impair competition in "access dependent" or related markets by (1) discriminating in the pricing of local bottleneck facilities to favor Bell companies, (2) discriminating against competitors in the complex process of providing the local access facilities (or information controlled by them) upon which the competitors absolutely depend, or (3) withholding critical design information and purchasing a manufacturing affiliate's products at inflated prices, despite the presence of better or cheaper products manufactured by others (so that inflated prices could be passed on to regulated ratepayers). These allegations led to numerous regulatory and antitrust proceedings.

First, they produced a variety of complex FCC proceedings. For example, the FCC instituted proceedings to assure that BOC procurement practices were fair (Docket 19129 [Phase II] and Docket 80-93), to assure that costs were properly allocated between competitive and monopoly telecommunications services (e.g., Docket 18128), to assure that monopoly revenues did not cross-subsidize equipment manufacturing (e.g., 80-743), to assure that technical information was disclosed in a timely fashion, to assure that access to the local exchanges was nondiscriminatory and the rates fair (e.g., Docket 78-72), to assure that the Bell System's competitive pricing responses were not predatory (e.g., Hi-Lo tariffs, DDS, MPL, Telpak), and to assure that detariffed telephone equipment competition would be fair (Second Computer Inquiry). These issues, however, were so complex that several of these proceedings spanned decades, without any final resolution. Indeed, it was only the entry of the Decree that allowed the termination of the various procurement dockets. During the 1970s and early 1980s, Congress, too, entered this quagmire and explored legislative requirements that were designed to attempt to prevent abuses of the local bottleneck and that, in many instances, were far more burdensome and inefficient than any alternative. See, e.g., H.R. 5158, 97th Cong. 1st Sess. (1981); S. 898, 97th Cong., 1st Sess. (1981).

Most significantly, the FCC regulation did not and could not assuage competitors' concerns or prevent antitrust controversies from mushrooming. Courts have uniformly held that Congress, in the Sherman Act, had intended that the FCC and the antitrust courts would both have jurisdiction over telecommunications firms and engage in "dual regulation" of them. The result was incessant and burdensome antitrust litigation. More than seventy (70) major private antitrust cases were brought against the Bell System in the 1970s alone, each of which claimed that the local monopolies had been "leveraged" to harm competitors in long distance, equipment manufacturing, or other markets. In addition, the United States filed an antitrust action in a 1974 case that sought to prevent any possibility of abuses of the local monopolies in the most direct way possible: by requiring AT&T to divest the local exchange monopolies and, in turn, prohibiting the divested BOCs from reentering any competitive businesses so long as the local telephone franchises retained their natural monopoly characteristics. In its formal relief proposal to the Court, the United States had stated:

"The Bell Operating Companies should be divested from the AT&T holding company and from each other. Ownership of the facilities should be separated so that the divested companies own only local exchange facilities and AT&T owns only intercity, or toll facilities (and manufacturing). . . ."Finally, the Court should enter appropriate injunctions to forbid (the divested) local distribution companies from entering potentially or actually competitive lines of business." *United States v. AT&T,* No. 74-1698 (D.D.C.), Stipulation Package No. 82 (Nos. 17 & 30).

AT&T had vigorously denied the allegations that it had abused its local exchange monopolies to obtain competitive benefits in all these cases. It also urged, equally vehemently, that the integrated Bell System was far more efficient than any alternative structure. However, it became increasingly apparent that the accusations of abuses were diverting major and ever-increasing resources of the Bell System and the entire telecommunications industry. These cases made it very clear that the continuing integration of the Bell System would have meant that the debilitating controversies would continue ad infinitum, even if the Bell System won the 1974 government case and no matter how the other pending antitrust controversies were resolved. Further, even though unfounded, the suspicions and charges of abuses of local exchange monopolies imposed other serious social costs, creating uncertainty and confusion that retarded the domestic industry's development.

Against this background, AT&T undertook to restore certainty and stability to the industry and to get the Bell Companies out of the antitrust and regulatory controversies in what appeared to be the only way possible: agreeing to the precise relief proposal of the United States in the 1974 government suit under the Sherman Act. The Bell System agreed to separate its interexchange and manufacturing businesses from its local monopolies (thereby freeing the competitive businesses from allegations that the local bottlenecks had been or could be misused) and to divest local monopolies that would be subject to line of business restrictions (thereby assuring that the divested BOCs, the post-divestiture AT&T, and the industry would not be subject to the same disputes and suspicions that plagued the Bell System).

AT&T agreed to this structural and injunctive remedy only after it and the Justice Department tried, and failed, to negotiate a detailed "regulatory" decree that would have established separate subsidiaries within the Bell System and other devices to prevent abuses. The reality was that no set of regulatory requirements could adequately resolve competitors' concerns and prevent disputes over discriminatory pricing, provisioning, and procurement by BOC monopolies when they are owned in common with competitive long distance and manufacturing businesses. Only a structural remedy could end the turmoil.

After conducting the extensive proceedings required by the Tunney Act, Judge Greene found that it was in the public interest to order the divestiture of the local exchange operations of the BOCs and imposed four separate line of business restrictions on the divested BOCs. They are prohibited from (1) providing interexchange services, (2) providing information services, (3) manufacturing equipment, and (4) engaging in businesses other than local exchange service, exchange access service, provision of customer premises equipment, and directory advertising. These injunctive requirements were imposed as a modification of the earlier 1956 Decree that had also addressed the combination of monopoly and competitive businesses by barring AT&T and the Bell System from engaging in any businesses other than common carrier communications service and the manufacture of equipment for them. Because AT&T would own no local bottlenecks and would participate only in intensely competitive businesses, it was relieved of the restrictions of the 1956 Decree, but was subjected to a seven-year prohibition on engaging in "electronic publishing" over "its own lines." Consistent with the theory of the case, as explained in more detail below, the restrictions on the BOCs were to continue only so long as the BOCs' local exchanges retained their monopoly characteristics.

II. THE POST-DIVESTITURE ADMINISTRATION OF THE DECREE

Since the January 1, 1984, divestiture, courts have strictly enforced the core line of business restrictions on the BOCs' participation in interexchange services and manufacturing. They hold that these are essential so long as the BOCs control local exchange bottlenecks. As Judge Greene stated earlier this year:

"[T]he 'bottleneck' monopolies continue to exist as before. These bottlenecks—i.e., the local companies with their ownership of the local switching systems and thus of the pathways which the interexchange and information providers must use if they wish to reach the ultimate consumers—merely changed hands: instead of being controlled by the management of AT&T, they are now being controlled in each region by the management of a particular Regional Company. However, the ability to exploit the bottlenecks anticompetitively has remained precisely the same. It was on this basis that the prohibition against the provision of interexchange and information services became a central part of the decree." Opinion, *United States v. Western Electric Co.*, January 16, 1986, p. 8 (footnotes omitted).

"The Regional Companies are not permitted to manufacture telecommunications equipment because the danger of discriminatory design is so substantial, and because neither the court nor regulatory authorities have any practical ability to recognize and police discrimination in technological design until it is too late. The alliance of exchange service and manufacturing was an overwhelming concern of the Decree. See 552 F. Supp. at 190-91." Opinion, *United States v. Western Electric Co.*, February 26, 1986, p. 25.

Indeed, within the last month, the appropriateness of these line of business restrictions on BOCs' owning local bottlenecks was reaffirmed by the Court of Appeals for the District of Columbia Circuit, in a panel including Judges James Buckley, Antonin Scalia, and Abner Mikva. In Judge Buckley's words:

"We are not troubled by U.S. West's observation that the decree's expansive definition of a BOC results in broad application of the decree's restrictions to RHCs and other companies affiliated with BOCs. This result is consistent with the decree's objective of sharply limiting the ability of businesses with bottleneck control of local telephone service to utilize their monopoly advantages to affect competition in competitive markets." *United States v. Western Electric Co.*, Nos. 86-5118, 5163, and 5164 (D.C. Cir. Aug. 15, 1986). (Slip. Op. p. 12).

The core purpose of the Decree was described by Judge Buckley as follows:

"The [Decree] split the Bell System into two basic parts—the competitive portion of the business, which would provide long distance service, manufacture telecommunications equipment, and conduct research, and the noncompetitive portion of the business, which would continue to have bottleneck control of local telecommunications service. The competitive portion was to be retained by AT&T and its Western Electric and Bell Labs subsidiaries, while the noncompetitive portion was assigned to the RHCs and their BOC subsidiaries. The distinction between the two portions of the business was to be preserved by creating 'exchange areas,' generally centering on a metropolitan area, within which BOCs would provide 'exchange telecommunications services' consisting principally of local telephone service. Id., Slip. Op. at 5.

In the same opinion, Judge Buckley significantly alleviated the restrictions on the BOCs as interpreted by Judge Greene. The Court of Appeals reversed Judge Greene's earlier holding that the Decree requires the BOCs to obtain the court's permission before they can provide local exchange services outside their regions. Id., at 12-20. By limiting the Decree Court's jurisdiction in that manner, the Court of Appeals significantly narrowed the administration of the Decree to the antitrust bottleneck theory which underlies the decree. It has thus eliminated much of the source of controversy and the conern that the Decree Court was exercising authority beyond the implications of the antitrust laws.

Most of the remaining post-divestiture controversy over the Decree's administration is a result of one limited aspect of it: the waiver process for the BOCs' line of business restrictions. Ironically, this procedure was originally insisted upon by Judge Greene in 1982 to ameliorate the effects of one of the four restrictions that the Decree imposes on the BOCs—the fourth "catchall" prohibition on their participation in businesses other than local exchange services, directory advertising, and the provision of CPE. Judge Greene recognized that this prohibition could be overbroad because there are many businesses that are so unrelated to local exchange service that there could be no "substantial possibility" just a BOC could use its monopoly power to impede competition in the market that it sought to enter. 552 F. Supp. at 195 n.267. Thus, Judge Greene insisted that a provision be added to the Decree permitting a BOC to enter such businesses, upon a proper waiver application and showing that there was no "substantial possibility" of impeding competition. Section VIII(C) permitting such waivers was then added to the Decree.

To date, the BOCs have sought over 100 waivers. The majority have been approved, including the right to provide foreign telecommunications services and to manufacture equipment in foreign countries (but not for import back into the

United States). Other waiver requests are pending. The only one that has been rejected in its entirety involved a proposed entry into the interexchange business.

AT&T has not opposed a single BOC request for waiver of the fourth "catchall" prohibition. To the contrary, shortly after divestiture, AT&T announced that it will not oppose a BOC's effort to diversify into businesses other than interexchange services, information services or the manufacture of telecommunications equipment which lie at the heart of the Decree.* Indeed, since divestiture AT&T has not opposed many BOC waiver requests involving local information services. Beyond that, AT&T has had a continuing interest in exploring options that could reduce the burdens of the waiver process, while not impairing the enforcement of the Decree's "core" prohibitions, so long as they are required by the natural monopoly characteristics of local exchanges.

III. LEGISLATIVE ACTIVITY SHOULD AWAIT THE OUTCOME OF PENDING PROCEEDINGS

The executive and judicial branches are now engaged in proceedings to reassess each of the Decree's substantive restrictions and requirements, including the basis upon which the core restrictions are premised, namely, that the local exchanges retain natural monopoly characteristics and are essentially noncompetitive.

These pending proceedings are rooted in the Decree itself. When the Decree was entered in 1982, both the Justice Department and the Decree Court recognized that the central premise of the Decree is that the BOCs' local exchanges are bottlenecks and that there may come a time when the local exchanges will lose these bottleneck characteristics with respect to interexchange services, information services, or equipment manufacturing. The Court recognized that "technological developments" in local exchanges or "changes in the structure of the competitive markets" could have this effect. 552 F. Supp. at 194. If that day comes, the Court recognized that the need for the line of business restrictions will disappear and that the restriction or restrictions can then be vacated. For these reasons, the Department of Justice has undertaken to report to the Court every three years concerning whether this central premise of the decree has changed and whether the need for any or all of the injunctive requirements has vanished. 552 F. Supp. at 194.

The first such report is due in January, 1987, and the triennial review process has been under way throughout the past year. In late 1985, the Justice Department appointed a special consultant, Mr. Peter Huber, to collect data concerning the continuing need for all or any of the restrictions imposed by the Decree. The Department and Mr. Huber invited the more than 600 participants in the public interest proceedings that preceded ratification of the Decree to submit comments and data relating to the broad policy issues, as well as to the narrower economic and technological issues. Representatives of all segments of the industry have participated in the process by making factual presentations, or submitting written comments to Mr. Huber, or both. This factual study will be used by the Department of Justice to formulate its recommendations to the Court concerning the Decree.

In addition, last Spring, the NTIA instituted its own investigation to address the continued appropriateness of the line of business restrictions on the BOCs. The NTIA study will consider the impact of the restrictions on international trade, employment in the industry and other issues. NTIA has stated that it will complete its study this fall, so that it, too, may be presented to the Justice Department in connection with its January 1987 report to the Court.

After the Court receives the Department's factual report and recommendations, it will consider what substantive modifications in the Decree are appropriate in view of the changes and experience of the past years. A decision is likely early in 1987.

Because the executive and judicial proceedings to gather relevant facts and to reassess the continuing need for the restrictions on the BOCs are under way, legislative consideration of the range of complex issues that the Committee has raised would seem to be singularly inappropriate at this time. One possible result of the executive and judicial review may be that the Decree is modified such that there is no need for legislation. For this reason, legislative activity would now be premature.

The relevant technological and competitive issues are now being thoroughly canvassed by the executive and judicial branches. In the absence of the facts that are being developed by these studies, Congress should not expend its resources and rush to judgment in the remaining days of this session on the complex issues of where jurisdiction should lie and whether competitive and other safeguards are required.

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*AT&T Response to Memorandum of The Department of Justice Concerning Removeal of Line of Business Restrictions, *United States v. Western Electric Co.*, No. 82-0192 (D.D.C.), filed March 23, 1984, pp. 1-5 (footnotes omitted).

The reality is that the other pending investigations could show either that the effort is unnecessary because of intervening changes in the industry or, alternatively, that it is still unworkable to integrate competitive services with the local exchange monopolies.

Finally, legislative activity now, before the results of the other proceedings are known, could impose serious costs on a critical national industry and the nation. As Charles L. Brown, AT&T's then Chairman, stated in testimony to this Committee's Subcommittee on Telecommunications last September, the massive changes in the telecommunications industry in the past years came at very high social and economic costs. What the industry needs now is stability, not additional legislation. James R. Olsen, AT&T's new Chairman, reiterated these points in a letter to Senator Danforth, dated July 3, 1986.

The public has only recently begun to see substantial benefits from these wrenching and far-reaching changes, with the Decree now achieving its central purposes. The BOCs are thriving and financially healthy in their exchange businesses. Local rates are stabilizing. Long distance rates have declined 22 percent. Competition in the telecommunications and information services and the manufacture and sale of telecommunications equipment is flourishing, and prices for these equipment and services are steadily declining, to the benefit of consumers.

In the remaining days of the 99th Congress, the Senate has a crowded agenda of pressing matters. The resolution of these telecommunications issues should not be undertaken in haste or on an inadequate record. Congress should not consider legislation that could again disrupt the industry, until the results of the pending studies are made available and judicial review of these matters is completed next year.

I thank the Committee for its invitation and would be pleased to answer any questions.

[The following information was subsequently received for the record:]

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question 1. Some parties have argued that the Bell Companies should be permitted to provide long distance, to ensure that AT&T faces some real competition in the market. How do you respond to that?

Answer. There is intense competition in the long distance marketplace today. AT&T fully documented this fact in the testimony of Alfred Partoll, which was given before the House Subcommittee on Telecommunications in March 1986. Consumers are already reaping the benefit of this competition. Over the past two years AT&T has reduced its long distance rates by over 20 percent and has introduced several optional pricing plans to attract and retain both residential and business customers. AT&T expects to continue to reduce rates and to devise imaginative pricing options to remain competitive.

The comments and statements that you have received from AT&T's long distance competitors are further testimony to the intense competition in the long distance market. MCI, U.S. Sprint, ALC, CompTel, NTN and others have opposed S. 2565, but not because they are pessimistic about their ability to compete. Rather, they argue that their growth over the past three years would be eroded if they were once again expected to compete against carriers who have monopoly control over the essential local telephone exchange facilities upon which all providers of long distance service must depend.

Question 2. Critics of the line of business restrictions argue that in negotiating the settlement, AT&T sought to keep the Bell Companies out of the businesses in which AT&T engages: long distance, manufacturing of telecommunications equipment, and information services. Is there merit to that criticism?

Answer. None whatsoever. The line of business restrictions on the BOCs were not "negotiated" by AT&T. They were implemented as essential features of the antitrust remedy that the United States, through the Justice Department, sought in *United States v. AT&T.* As documented in my written testimony of September 16, 1986, the Justice Department's formal proposal for relief in that case was for the divestiture of local exchange monopolies that would be subject to these lines of business restrictions. The Department reiterated this position throughout the trial in *United States v. AT&T,* and in the subsequent proceedings after the settlement was filed. Indeed, the Department stated in its Competitive Impact Statement (pp. 38-42) and in other filings to the District Court and the United States Supreme Court that these restrictions must be imposed to achieve the competitive objectives of the Sherman Act and to end the decades of competitive controversies that led to the Decree.

The District Court and the Supreme Court agreed in 1982. As my testimony demonstrates (pp. 9-11), D.C. Circuit Judges Buckley, Mikva, and Scalia recently recognized that the line of business restrictions are a necessary and proper antitrust remedy.

In short, as AT&T's former Chairman, Charles L. Brown, has stated many times in the past, the Decree was not AT&T's idea. AT&T agreed to the very same antitrust relief that the Department of Justice asked for in *United States v. AT&T* because it appeared to be the only way to end the incessant competitive controversies and assure that the post-divestiture AT&T, the BOCs, and the industry would not, again, be mired in the turmoil that led to the Decree.

Question 3. Mr. Marshall, your company has taken the position that it's premature to legislate now in this area. What facts do you feel we need before we consider this matter?

Answer. Generally, a thorough analysis of the current state of the telecommunications industry is needed. For example, what effect has divestiture had on the closely related competitive markets? As explained in my last answer, the government expected that divestiture would end the competitive controversies and facilitate fair competition in the long distance, telecommunications equipment and information services markets.

A fundamental factual issue that is now being investigated by the Justice Department and NTIA is whether, and to what extent, the local exchanges of the BOCs retain their monopoly characteristics for participants in the long distance, equipment manufacturing, information service, or other markets, and whether antitrust policies and competitive concerns continue to require that BOCs be excluded from some, or all, of these markets. In AT&T's judgement, these are important studies that this Committee and interested parties need to review before considering restrictions under broad "public interest" standard in which the promotion of competition is not necessarily the paramount consideration.

If the local exchanges continue to be essential monopoly facilities for one or more of these competitive businesses, history teaches that elimination of a restriction under a broad public interest standard will recreate the predivestiture turmoil and incessant competitive controversies. Congress would have to assess whether other considerations could nonetheless justify the imposition of these social and economic costs. Conversely, if the local exchanges have lost their monopoly characteristics for one or more of the now-restricted businesses, the consequences of eliminating the line of business restriction might be very different. These considerations counsel that Congress wait the few months until the pending investigations into the current state of the local exchanges and the judicial review of the need for each of the restrictions are completed.

The appropriateness of waiting until 1987 is vividly confirmed by the fact that the pending investigations of NTIA and the Justice Department encompass some of the very questions about trade, labor, and competitive safeguards that the Chairman raised. Indeed, on September 10, 1986, Douglas H. Ginsburg, the head of the Antitrust Division, testified that he could not now respond to the Chairman's questions about safeguards but could do so after the Justice Department's investigation is concluded.

A final factual issue that has been given no specific consideration by the Committee is whether S. 2565 is constitutional. A distinguished constitutional scholar, Henry P. Monaghan, the Thomas M. Macioce Professor of Law at Columbia University, recently concluded that, while Congress could constitutionally transfer authority over the Decree to the FCC if it did so directly, S. 2565 is a patent violation of long settled principles of separation of powers.

Question 4. AT&T probably knows the FCC more thoroughly than any other business organization does. In your judgment, is the FCC capable of administering the AT&T divestiture decree?

Answer. The FCC is certainly capable of regulating matters within its special expertise, its rules, and jurisdiction under the Communications Act of 1934. However, it is clear from the hearing record that the issues facing the telecommunications industry in S. 2565 encompass much more than these matters.

This is especially so because the legislation involves an antitrust decree and the FCC does not have jurisdiction that is coextensive with, or exclusive of, the antitrust courts. Nor does the legislation propose such an expansion of the Commission's jurisdiction. The FCC is governed by a broad "public interest" standard in which promotion of competition is not the paramount consideration, but is merely one factor that the FCC may consider. Further, the FCC has jurisdiction only over interstate common carrier services and is statutorily barred from regulating the intrastate services that generate some 80 percent of BOC revenues. See 47 U.S.C. Section 152 (b); *Louisiana Public Service Comm'n v. FCC*, 106 S. Ct. 1890 (1986).

The CHAIRMAN. Gentlemen, thank you very much.

Some people think that if the FCC were given jurisdiction over this matter it would proceed to lift the restrictions on the Bell Operating Companies, and that in short order we would be back to the situation we were in with AT&T prior to divestiture, except that there would be seven monopolies rather than one monopoly.

Do you have any views on that concern?

Mr. MARSHALL. Well, Mr. Chairman, let me answer first. I would not prejudge what actions the FCC would take. I can only take it at face value, because I respect his opinion, the comments made by Chairman Fowler, that he has not prejudged the issues.

My concern is not what actions would be taken, but whether or not we would not be in a better position three months from now to know whether that is in the right direction.

The CHAIRMAN. Well, I understand your testimony.

Let me then ask you a hypothetical question. Let us suppose that the line-of-business restrictions were lifted from the Bell Operating Companies. Would that result in seven pre-divestiture AT&Ts?

Mr. MARSHALL. I believe that if the line-of-business restrictions were lifted at a time when it had not yet been found that the monopoly was gone, that the conditions for which the restrictions were placed, that we would be back into a situation of chaos again because that was the hallmark of the decision that was so wrenching to me personally and all of us in the Bell System only a few years ago.

The CHAIRMAN. But would it recreate the same situation we were in before, except that there would be a geographical division of territory, but essentially the same conditions that existed pre-divestiture?

Mr. MARSHALL. I do not mean to be redundant in what I say, but if the monopoly conditions were not yet found to be gone, then there would be the same opportunity for challenge to those seven companies that we within the Bell System found ourselves challenged by in 70 antitrust suits, as well as the Federal case.

The CHAIRMAN. What is your comment, Mr. Schmults?

Mr. SCHMULTS. Senator Danforth, I am troubled by the concept that we should not do it now, and that we will be returning to chaos, or we do not need more change. We really view S. 2565 as a process bill, not a substantive bill.

What is really going to happen with S. 2565, if enacted, is that we are going to lift in effect the administration of these Consent Decrees and put it in the administrative agency that is basically charged with determining telecommunications policy and implementing it under congressional oversight.

I think what is important is that in that process before these line of business restrictions are lifted, if they are to be lifted, you would have a thorough review of the situation. During the FCC comment period all interested parties would be represented. This committee could summon Chairman Fowler and the other Commissioners up here during that process to ascertain what they were doing. There would be appeal to the courts. Congress could enact a statute. Thus, in the FCC you would get a much fuller consideration of the important public policy issues.

So we think, as I have said, that this would be a wise thing to do. We have not prejudged in any way, and I do not think you can, what the FCC would do. In this respect, I agree with Mr. Marshall. We assume that the FCC will act in the public interest and decide what it thinks is right at the appropriate time. So far as lifting the restrictions, the FCC may or may not impose some new restrictions; or I may do it piecemeal, or they may——

The CHAIRMAN. Let me just give you a hypothetical.

Mr. SCHMULTS. All right.

The CHAIRMAN. Let us suppose they lift the restrictions.

Mr. SCHMULTS. Well, first of all, I do not think you are ever going to put the genie back in the bottle and recreate the old Bell System. We have moved beyond that.

The CHAIRMAN. Well, why would we not create the old Bell System if there were no restrictions on the operating companies, and the only difference is that there are seven of them, and the FCC says you can do anything. You can manufacture equipment, get into the long-distance business, and the information business.

Mr. SCHMULTS. Well, when you say "lift the restrictions," I assume that the restrictions would not be lifted in a way that would permit the Bell Companies all to interconnect to one another again.

The CHAIRMAN. Well, that is the question that we have. In other words, if we turn over total responsibility to the FCC, we do not know what they are going to do. The question is, do we want to put any parameters on the FCC?

It seems to me there are three options we have if we want to do anything. One is to just turn over responsibility to the FCC, as Senator Dole's bill would do.

The second option would be a process option somewhat on the same lines as the suggestions that I put out a few weeks ago.

The third option is very specific restrictions that are imposed by Congress itself.

Those are the three options. You are suggesting that we just go with the first, that we say Congress is not in this business anymore.

Mr. SCHMULTS. No, no, I am not suggesting that, Senator. I am suggesting the first option, but not that the Congress is not in the business anymore. Congress is certainly in the business. It is Congress' responsibility to set the policy.

I think what I am suggesting is that if you slipped into the third option and you began to enact legislative restrictions and in effect engage in your own prejudging, you could well be wrong. Given the pace of change, and whatnot, that the importance of the administrative process is that it is flexible and can respond quickly.

The CHAIRMAN. I agree with that. I do not want Congress to be in the business of sort of taking over Judge Greene's role. It seems to me the issue is is it done in the court, or is it done in the regulatory agency. The question now before us is, if it is done in the regulatory agency, then what limitations if any should we impose on that regulatory agency?

My specific question to each of you—and I really have not understood the answer that you have given—is: If there are no limitations on the Bell Operating Companies, would they then become seven reincarnations of the old AT&T?

Mr. SCHMULTS. I cannot answer that question. I do not know how anyone could answer that. It would depend what they did, when they did it. There is no reason to believe they would act in the same way. Clearly the antitrust laws would still be in effect, and if they were beginning to recreate something akin to the old Bell System, presumably those antitrust concerns would rise again and you could well have another antitrust case.

The CHAIRMAN. And Judge Greene would be back in business.

Mr. MARSHALL. Senator, may I make a comment? As a 33-year veteran of largely in the Bell System and now in AT&T without the Bell System, I would just want to clarify that I think if we reincarnated the Bell System, it was not a bad system. It was not, in my deep-down judgment, guilty of misusing the strength it had. But the suspicion of that ability being contained within a corporation is what you are probing at, and I think that is a concern.

The CHAIRMAN. Senator Gorton?

Senator GORTON. I have a question for both of you, and maybe for the Chairman.

Does the Dole bill allow AT&T to do whatever it wants? Does it remove or allow the FCC to remove any restrictions on AT&T?

Mr. Marshall, are you anxious to go into local phone service, or yellow pages, or something of that sort?

Mr. MARSHALL. No, sir—well, yellow pages could be attractive for a lot of companies, but, no, that is not on our agenda. I think it would be impossible for a company even with our size to go back into the local exchange business. The networks that are out there would be virtually impossible to recreate for someone else, and frankly the economies of scale and the superb levels of service now given by those local companies do not invite that.

So to me the Dole bill does two things. One, it suggests that there be a change in the authority from Judge Greene's court, and then he would be asked to vacate over to the FCC. But probably more importantly it changes the standard on which those decisions were based from the antitrust standards, which is why Judge Greene had it in the first place, over to a public interest statute standard. That is a more significant change right now for us.

Senator GORTON. Does it do that for AT&T as well as for the Bell Operating Companies?

Mr. MARSHALL. I do not see an impact upon AT&T, Senator.

Senator GORTON As I understand, one of the real surprises with respect to the way in which the modified final judgment has been administered is the large number of waivers for businesses which are outside the traditional communications business which have been applied for by various Bell Operating Companies—real estate, paging services, financial businesses, and the like—and my understanding is that only one of them has been denied so far.

Do you, while you oppose this bill, think that there is some way that the Consent Decree or the waiver process itself could be modified short of total removal from the court which would alleviate some of these concerns, but still protect your own?

Mr. MARSHALL. Ed, if I might answer this first, and then you can comment if you would like to.

I think you raise a very important point, Senator, because let us take first the Department of Justice inquiry under Peter Huber, which will be revealed to all of us in January. Many people are aware that it is looking at the injunctive relief in the three major areas that the antitrust standards block entry.

I think equally significant is that Mr. Huber is charged with looking the process over. I would expect that everybody, including you from your statement a moment ago, has been surprised by the number of waivers and therefore the amount of work that has been put upon the Department of Justice over what was anticipated.

We at AT&T have not involved ourselves, or tried to block, very many at all of those, in fact very few. I would not be surprised to find that the Department of Justice study would say that that process which looks over business opportunities other than those in the three injunctive relief areas might well not be handled by someone else, and that someone else could well be the FCC who has both the expertise and the manpower and the congressional oversight to do that very well. That would not surprise me.

But again, that is just one of the things that I believe, one of the facts that could become available to all of us in such a very short time, if that is true. I am not a very good seer into crystal balls, but I would think that is clearly a possibility.

Senator GORTON. Mr. Schmults, did you want to comment on that?

Mr. SCHMULTS. Well, I would essentially agree with that. I think the Decree could be changed obviously by Judge Greene and the parties if the Huber report recommended something like that, but that really would not deal with what I think is of central concern. That is, simply that telecommunications is too important to the nation to have policymaking so fragmented. I really do not think it makes any sense for something that is so essential to this country as telecommunications to continue competing or parallel or overlapping regulatory authority.

Presumably we are moving, and will continue to move, into a deregulated environment, so the heavy hand of regulation will be reduced over time; but it is just too complex a process now. It is awkward. It does not make any sense as a matter of public policy.

So our position is very simple. That is, that the Dole bill is good as a process bill. The process ought to be changed. I am not minimizing for one minute the concerns reflected in Senator Danforth's proposals, or the concerns that others will express here. My only argument is they can best be considered at the FCC.

Congress has no oversight now over Judge Greene. Judge Greene could lift the restrictions in the Consent Decree if he wanted to. It seems to me that it places things in a more orderly way that will promote certainty to put the authority at the FCC and then let Congress decide how it wants to direct the FCC. We can then see how the process works.

So that it would not be enough for GTE to just streamline or tinker with the Consent Decree, but leave that authority in the hands of Judge Greene, Senator Gorton.

Senator GORTON. Thank you, Mr. Chairman.

The CHAIRMAN. Well, Mr. Schmults, the suggestions that I made in late August were process suggestions. Do you have a view about them? Do you just like the Dole bill as is? Do you have any particular objections to the concept in those proposed amendments?

Mr. SCHMULTS. Our position, Senator Danforth, is that restrictions at the outset on FCC discretion probably are not a good idea because history has told us they are likely to be the wrong ones and are not going to work. We could well find they have a perverse effect on consumers and ratepayers.

The CHAIRMAN. I am not talking about specific limitations, but rather matters that should be considered and a process by which they should be considered.

Mr. SCHMULTS. Yes. I was going to go on to say that directions to the FCC to take into account and to focus on trade interests, to take into account concerns about cross-subsidization or other things, or directing the FCC to consider very carefully the views of the Commerce Department or the Special Trade Representative would be something that we would find acceptable.

I would not put such directions under the category of restrictions. You did mention that somebody had advanced the idea that perhaps Executive Branch agencies could have a veto. We would oppose that. That would be regulation by stalemate; if anyone objected to action there would be no action.

The CHAIRMAN. Mr. Marshall, do you want to comment in this area? I know that this is not along the line of your testimony, but if you have any thoughts on those proposals I would like to hear them.

Mr. MARSHALL. Thank you, Mr. Chairman.

As we indicated in Mr. Olsen's letter to you sometime ago, and as I indicated to you in my written testimony, we would be more than pleased to work with this Committee or whatever agency in looking at what those might be, what those steps might be to take a look at a dynamic marketplace.

People who are not in this marketplace think that it does not change. I do not know how they can think that. If they were a part of it, they would know it changes almost weekly. There is no reason to prejudge that the conditions that existed in 1981 and 1982 and early 1983 are necessarily the marketplace today.

That is why I look forward with a great deal of expectation to what we are going to see as the assessment of the current conditions. Once we know that, then I think we all ought to entertain what are the possibilities of making this an increasingly competitive marketplace for everyone, and that is what we are all about.

So, yes, we would be more than happy to work with you or with others in determining what are the criteria for judging what kind of changes should be made.

The CHAIRMAN. Do you have further questions?

Senator GORTON. No.

The CHAIRMAN. Gentlemen, thank you very much for your testimony.

Mr. SCHMULTS. Thank you, Mr. Chairman.

Mr. MARSHALL. Thank you.

The CHAIRMAN. The next panel will be William G. McGowan, MCI Telecommunications; Charles Skibo, U.S. Sprint; George Vasilakos, ALC; and Jack MacAllister, U.S. West.

Mr. McGowan, your name is first on the list. Would you like to proceed, please?

STATEMENTS OF WILLIAM G. McGOWAN, CHAIRMAN, MCI TELECOMMUNICATIONS; CHARLES SKIBO, PRESIDENT, U.S. SPRINT; GEORGE VASILAKOS, PRESIDENT, ALC; AND JACK A. MacALLISTER, PRESIDENT AND CEO, U.S. WEST INC.

Mr. McGowan. Thank you, Mr. Chairman.

Mr. Chairman, Members of the Committee, I appreciate this chance to express MCI's unalterable opposition to legislation that would transfer authority over the MFJ from the courts to the FCC. The proposals embodied in S. 2565 to strip the Federal court of its ability to enforce an existing injunctive Decree in a pending antitrust case is not just a bad idea, it is unnecessary, it is unfair, it is probably unconstitutional, and it is wholly unprecedented in this country.

Let us face it. There are many good reasons why this Consent Decree is now in place. I will mention two. Number one, antitrust cases brought by the Government and others prove that the Bell Companies abused their control of local exchange. Their monopolies gave them both the ability and incentive to discriminate illegally against their competitors.

Number two, the FCC was clearly unwilling and unable over a long period of time to prevent these abuses. The result was decades of litigation and chaos within the industry. A local exchange monopoly is still in place. There have been no structural changes in the two-and-a-half years since divestiture. The FCC's attitude toward antitrust enforcement has not changed, either.

As you know, members of the Commission are already on record as favoring elimination of key safeguards in the Consent Decree. The Bell Companies are now pushing S. 2565. Just a few years ago they agreed to the restrictions that they now want Congress to consign to the FCC graveyard.

The Bell Companies agreed to the Decree because they were faced with the certainty of an adverse judgment on antitrust liability and its promise of an even worse remedy. How short are our memories.

What message would congressional intervention send to corporate America about the risks involved in violating the antitrust laws? What precedent would be established for court stripping legislation whenever a judge makes a hard decision in a controversial case?

Any effort to bail the Bell Companies out of their legal obligation would threaten the most fundamental constitutional principle of an independent judiciary.

Mr. Chairman, I recognize that these hearings were called by you to focus on a number of comprehensive policy proposals and questions you have raised in considering the merits of amending S. 2565. We are reviewing each of these carefully and hope to be able to share our views on them with you in the near future.

Today, however, I hope I can convince you to amend S. 2565 by striking everything after the enacting clause.

I respectfully urge this because in my opinion S. 2565 fails to address, let alone solve, the right issues. As I listened to the congressional debate over telecommunications policy I hear concern about rising local rates and the ever-increasing telecommunications trade imbalance, but the proposed transfer of Decree authority to the FCC would do little to address these concerns.

Allow me just a few moments on these two points.

First, injury to consumers: While long-distance rates have dropped by approximately 25 percent since divestiture, during this same period local rates have increased by more than $5 billion. Instead of concentrating on providing equal access and the best possible local exchange service at the lowest possible price, the Bell Operating Companies are using their record profits and monopoly revenues to finance a diversification frenzy that could threaten the pocketbooks of consumers from coast to coast.

The average ratepayer has little to gain if these diversification efforts go well. Profits from the yellow pages, for example, have not been returned to the rate base, and it is unlikely that any competitive profits will be used to lower rates. What happens if the competitive ventures do not make money? What if the already huge losses which last year totalled about $1 billion continue to rise? The temptation to engage in cross-subsidy becomes even greater. In fact, that may already be happening.

The California Public Utility Commission staff, for example, just issued a report concluding that Pacific Tel has improperly used ratepayer dollars to subsidize its new competitive ventures. Auditors looking at the operationg of three other Bell Companies were, and I quote here, "denied access to materials pertinent to their studies."

This should have had a familiar ring to anyone who remembers cross-subsidization between the competitive and rate-based business of the old system. State public utility commissions have repeatedly complained about the Regional Bell Holding Company's refusal to provide the kind of information necessary to effectively police discrimination and cross-subsidies.

Chairman Paul F. Levy of the Massachusetts Department of Public Utilities recently described his State's efforts to prevent Nynex from using its telephone subsidiaries as "cash cows" for competitive ventures, and his efforts were fruitless.

Sharon Nelson, Chairman of the Telecommunications Committee of the Western Conference of PSCs put it this way in a recent letter to the Justice Department: "It would be false to assume that the lifting of the MFJ restrictions can proceed with confidence that state regulators have the ability to effectively control cross-subsidies."

Second, to trade. The real cause of the trade imbalance is unreasonable foreign restrictions on the sale of American telecommunications services and products abroad. We have in this country a free and open market to all international telecommunications equipment suppliers and service suppliers. We have made progress in removing restrictions on our equipment exports.

However, by contrast, major countries such as West Germany have yet to agree to allow voice service to be provided by all carriers. This situation will be further aggravated as more overseas organizations establish direct or indirect telecommunications services here in the U.S.

I urge the Committee to abandon S. 2565 and turn its attention to more pressing issues in American telecommunications. I have attempted to suggest some of these issues—the Bell holding company structure and foreign trade restrictions—today. By addressing these problems, congress can bring real relief to the American Telecommunications Consumer.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much. Mr. Skibo.

[The following information was subsequently received for the record:]

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. What has changed since divestiture that prevents the BOCs who control local monopoly facilities, from discriminating against other long-distance carriers?

Answer. Nothing has changed since divestiture to reduce the BOCs' ability to discriminate. Discrimination has been minimized since divestiture only because the line-of-business restrictions of the MFJ, which prohibit Bell interLATA long-distance services, have removed BOC incentives to disadvantage long-distance companies. Under the consent decree, long-distance companies were transformed from the BOCs' competitors into the BOCs' largest customers for interexchange access. This transformation gave the BOCs the incentive to provide long-distance access fairly and expeditiously. The dramatic decline in telecommunications litigation and controversy since divestiture demonstrates that the line-of-business restrictions are achieving their intended result.

If the line-of-business restrictions were removed, however, the BOCs would again compete against long-distance companies dependent upon the BOCs for access to their customers.

There is every reason to believe the BOCs would once again use their local exchange bottlenecks to provide access to competitors only in an unfair and discriminatory manner. The Bell System slowed the advent of long-distance competition significantly by denying competitors fair local interconnections. The BOCs should not be permitted to threaten the continuing development of competition in the same fashion today.

The BOCs argue that bypass, by creating access alternatives, has lessened the danger of discrimination. But every customer, residential and business, large and small, is dependent on the BOCs for the vast majority of their access to local and long-distance telephone service. As Douglas Ginsburg of the Department of Justice noted last March, "[s]urely households and, in terms of absolute numbers, all but a small minority of businesses continue to face a monopoly provider of local exchange service and of access to long distance and information carriers."[1]

More recent information bears out Mr. Ginsburg's conclusion. Earlier this month, the California Public Utilities Commission argued that existing evidence of bypass "is merely of an anecdotal and self-serving nature."[2] The California commission noted that if bypass were truly harmful, there would be evidence of the BOCs losing money yet, as it explained, "most [BOCs] are doing very well.[3] The Ad Hoc Telecommunications Users Committee recently announced a study finding that the BOCs control fully 95 percent of "local exchange and interexchange access, private line and other local distribution services."[4] Bypass has not eliminated the BOCs' local exchange bottleneck.

With that bottleneck comes the ability to disadvantage long-distance companies that depend upon it. Last June, MCI submitted to the Department of Justice's Peter Huber a detailed report explaining how the BOCs could use their local exchange monopolies to discriminate against long-distance competitors in the critical areas of marketing, provisioning, technical quality, and maintenance and testing.[5] Nothing has occurred in the last three years to render these forms of discrimination any less devastating than when the Bell System used them through the 1970s and early 1980s against MCI and other fledgling long-distance competitors.

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[1] Statement of Douglas H. Ginsburg, Assistant Attorney General, Antitrust Division, United States Department of Justice before the Subcommittee on Telecommunications, Committee on Energy and Commerce, United States House of Representatives, at 12 (Mar. 13, 1986).

[2] Communications Daily, Sept. 4, 1986, at 1.

[3] *Id.*

[4] Communications Daily, Aug. 25, 1986, at 5.

To the extent equal access has been implemented (see Question No. 6, below), it pertains primarily to the technical specifications of access for long-distance services. It does little to prevent discrimination in the marketing, provisioning, and maintenance of switched services. Moreover, equal access only reduces discrimination if its requirements are strictly enforced. Although Judge Greene has done an admirable job of equal access enforcement, equally effective oversight could not be expected from the FCC. After all, it was the FCC's inability or unwillingness to prevent discrimination—for over ten years—which made court-ordered divestiture and the line-of-business restrictions necessary in the first place.

The BOCs argue that new regulatory concepts such as "open architecture" might prevent discrimination. Yet even the BOCs admit that open architecture is now "little more than a concept" which is years away from possible implementation.[6] In short, regulation would be no more effective at preventing discrimination today than it was before the consent decree. It would also be much more expensive than the line-of-business restrictions.

The BOCs retain their ability to discriminate against long-distance firms and others dependent on the local exchange to reach their customers. This discrimination has been minimized only by the line-of-business restrictions imposed by the Court pursuant to the antitrust laws. S. 2565, by placing administration of the consent decree in the hands of an agency committed to its elimination or substantial modification, is effectively a legislative repeal of those safeguards. Thus, S. 2565 proposes a return to the anticompetitive misconduct that stifled the development of long-distance competition and made the AT&T antitrust litigation necessary.

Question. What role should state regulators have regarding intrastate long distance? Should they get specific powers under any legislation? The FCC cannot regulate purely intrastate long distance today. Would or should legislation give them the power to do so?

Answer. Although the FCC has authority to regulate intrastate activities that significantly affect interstate telecommunications, the regulation of purely intrastate telecommunications, the regulation of purely intrastate long-distance services is today reserved to the states. While recent judicial and regulatory events make this a complex and changing policy area, MCI believes the existing balance of federal and state jurisdiction is appropriate for now. Although MCI has been disappointed that some states have moved slowly in providing their residents with the benefits of intrastate long-distance competition, federal intervention is neither necessary nor appropriate at this time.

Question. Some analysts think the long-distance market-place may settle down to AT&T, MIC and one or two much smaller and less profitable firms. Don't you think the Bell Companies might well be the only potential competitors able to stand up to AT&T and MCI? Wouldn't consumers benefit from this additional competition?

Answer. While the interexchange market is clearly undergoing change and some consolidation, there is no reason to believe that only three or four long-distance competitors will survive. At the end of August, 1986, there were at least 295 companies offering switched long-distance service in the United States, up from 190 a year earlier.[7] The long-distance marketplace continues to enjoy intense competition from many competitors. Indeed, if competition were to develop more quickly, the risk of unnecessary and socially wasteful excess long-distance capacity would be severe.

Although AT&T remains dominant, AT&T and MCI are not the only companies optimistic about their long-term prospects in the long-distance market. US Sprint, for example, recently announced that it will complete a $2.5 billion fiber optic network reaching each of the country's LATAs by the end of next year.[8] The company expects to have a 10 percent share of the long-distance market by the early 1990s.[9] ALC Communications recently announced plans to expand its 500,000-customer base by actively competing for AT&T customers and by introducing an 800 service to compete with similar services offered by AT&T and MCI.[10]

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[5] MCI's Response to Certain Questions Concerning the Continuing Need for Line-of-Business Restrictions on the Bell Companies, June 18, 1986, at 18-33. A copy of MCI's Response has been provided to the Committee.

[6] See Reply Comments of Southwestern Bell Corporation, at 31, Computer III Inquiry, CC Docket No. 85-229 (FCC filed Jan. 21, 1986) (open architecture "is little more than a concept at this time"). According to Pacific Telesis, open architecture may come "some time in the next decade" and even then will not be a "panacea." Reply Comments of Pacific Bell, Nevada Bell, PacTel Communications Companies, and Pacific Telesis Group, at 24, Computer III Inquiry, CC Docket No. 85-229 (FCC filed Jan. 20, 1986).

[7] The FCC recently announced that 295 entities had been assigned Carrier Identification Codes ("CICs") by the end of August, 1986, up from 190 a year earlier. CICs are codes used by customers "to reach services of long-distance carriers offering Feature Group B or Feature Group D." Communications Daily, Sept. 18, 1986, at 10.

Even if only a few long-distance companies were to survive, however, the BOCs could add little to the long-distance market that would benefit consumers. AT&T, MCI, US Sprint, and other existing competitors have spent billions of dollars over many years constructing nationwide long-distance networks. The BOCs lack national networks, and could construct them only over time and at enormous expense. Thus, there is a real danger that the BOCs would use their control of local exchange bottlenecks, and their ability to cross-subsidize from captive local ratepayers, to offset their lack of national networks. Consumers would be better off without this kind of unfair and unlawful competition.

Question. What do you think of the idea of allowing the Bell Companies to provide interstate long-distance services if competition exists, or is not legally barred, in intrastate long-distance services?

Answer. As explained above (see answer to Question No. 1), the problem with Bell entry to the long-distance market is the inherent competitive risk that the BOCs will once again use their local exchange monopolies unlawfully to discriminate againt existing long-distance companies. Additionally, there is the danger that the BOCs would again cross-subsidize their long-distance services with local ratepayer dollars, unfairly increasing the cost of local telephone service. These dangers would exist regardless of the state of intrastate long-distance competition. Thus, lack of legal barriers to intrastate competition is not a reason to relax the consent decree's line-of-business restrictions.

The question suggests a trade-off between allowing instrastate toll competition and BOC entry into the interstate business. However, the interstate and intrastate businesses are not comparable. Revenues associated with intraLATA markets are much smaller than interLATA revenues. Moreover, much of the intrastate toll market would not be subject to effective competition even if entry were allowed. Many toll routes are quite short and will remain effective monopolies for some time. It was, in part, for this reason that the LATA structure was created by the MFJ. Even where competition has been allowed by the states, the BOCs retain advantages even beyond their ability to discriminate and cross-subsidize. For example, the BOCs have been allowed to siphon off all intraLATA dial 1 traffic, even from MCI's customers. Finally, equal access conversions are moving even more slowly outside of major metropolitan areas. For a number of reasons, including attempts by independent telephone companies to block toll traffic from customers in unconverted end offices, competition with inferior access is becoming even more difficult than in the past.

The more important issue, from a line-of-business perspective, is the lack of effective competition in the local exchange access facilities used by long-distance companies to reach their customers. Even absent legal barriers to exchange competition, considerations of cost and technology prevent the development of real alternatives to the BOCs' local networks. As a result, the BOCs retain the ability to discriminate and cross-subsidize.

Question. Have the Bell Companies satisfied the equal access requirements of the AT&T divestiture decree?

Answer. The BOCs have not complied with the decree's equal access requirements, and apparently do not plan to do so until 1992 or later. Under the AT&T decree, the BOCs were required to offer equal access through at least one-third of their access lines by September 1, 1985, and to offer equal access from every end office requested by a long-distance carrier by September 1, 1986 absent an order from Judge Greene permitting later conversion of specific end offices.[11]

Two of the BOCs, NYNEX and Pacific Telesis, were not in compliance with their equal access obligations as of September 1, 1985.[12] Every one of the BOCs missed the September 1, 1986 deadline for converting all end offices for which a long-distance carrier had requested equal access.

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[8] Communications Daily, Sept. 19, 1986, at 5.

[9] *Id.*

[10] Communications Daily, Sept. 17, 1986, at 5.

[11] Consent Decree, Appendix B, Paragraph A.

[12] Report of the United States to the Court Concerning Equal Access Implementation, ***United States v. Western Electricl Co.,*** Civil Action No. 82-0192, at 3-4 (D.D.C. filed Feb. 7, 1986).

Between early 1984 and February of this year, MCI specifically requested equal access from approximately 1400 BOC end offices serving more than 13 million access lines. Each of the BOCs responded that they would not offer equal access from these offices by September 1, 1986. Bell Atlantic proposed to complete all the requested conversions by the end of 1987.[13] Four other BOCs, Ameritech, BellSouth, Southwestern Bell, and Pacific Telesis, have refused to offer equal access from all their offices until the end of 1988.[14] NYNEX and U.S. West propose to delay their completion of equal access until 1992, or even later.[15]

The BOCs have refused to meet the equal access schedule, moreover, in some of the most important areas of the country. End offices in Chicago and the Detroit, Denver and Tucson suburbs are not scheduled for equal access until 1988 at the earliest.[16] End offices in southern Manhattan, which serve some of the most important telephone markets in the country, will not be converted to equal access until 1990.[17] The largest end office in the United States, located in Royal Oak, Michigan, will not be converted until 1988.[18] MCI has protested the BOCs refusal to offer equal access on schedule to Judge Greene, and the matter is still pending.

The BOCs have thus failed to meet their equal access requirements under the *AT&T* decree. Indeed, they presently plan not to meet the decree's requirements until 1992 or later, more than six years late. In the meantime, consumers across the nation will be denied the benefits of full long-distance competition.

Moreover, completion of the BOCs' equal access conversion process will not exhaust their obligations under the MFJ. The conversion process now underway relates only to equal access for ordinary switched long-distance services. The MFJ, however, requires the BOCs to provide equal access for all kinds of telecommunications services. As new telecommunications services and technologies require new forms of access, the MFJ will continue to play a crucial role in ensuring that consumers can choose fairly between all long-distance competitors.

Mr. Skibo. Thank you Chairman Danforth and distinguished Members of the Committee for the opportunity to present U.S. Sprint's views on S. 2565. I have submitted written testimony for the record and would like to take a few minutes to summarize our position.

U.S. Sprint is opposed to S. 2565 for essentially three reasons: First, there is simply no public interest justification for Congress to consider shifting the jurisdiction over the AT&T Consent Decree from the Department of Justice and the courts to the FCC at this time.

Second, the court and the Justice Department are the appropriate entities to administer the antitrust laws and to prevent a recurrence of the problems that gave rise to the divestiture.

Third, if Congress is going to expend the resources necessary to consider telecommunications legislation, there are issues more critical to the preservation of a competitive marketplace that should be considered.

We fundamentally agree with the concept that the FCC should primarily be responsible for federal telecommunications regulation; but the AT&T Consent Decree primarily deals with antitrust issues. The courts are responsible for enforcing the antitrust laws. The FCC is not.

Keep in mind that the Bell Operating Companies were prohibited from entering the long distance market by the AT&T Consent

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[13] See MCI's Objections to the RBOCs' August 1 Filings Concerning Bona Fide Requests for Equal Access Conversions, *United States v. Western Electric Co.*, Civil Action No. 82-0192, at 19 (D.D.C. filed Aug. 15, 1986).

[14] Id.

[15] Id.

[16] Id. at 16.

[17] Id. at 16–17 n.42.

[18] Id. at 16.

Decree for a very real antitrust reason. The prohibition was designed to prevent the anti-competitive abuses—specifically, the preferential treatment for their long distance business, AT&T—that existed prior to the divestiture. Until the Bell Operating Companies' control over "bottleneck" local exchange facilities is eliminated, the threat of anti-competitive abuses continues to be very real.

Circumstances have not significantly changed since divestiture, but the BOC's still seek to escape restrictions to which they and the courts so recently agreed. To achieve such extraordinary treatment, they must bear the burden of proof that the public interest, not just their own, will be served.

In fact, it is apparent to us that if the Bell Operating Companies are allowed into the competitive long distance market before these antitrust concerns are resolved to the court's satisfaction, there will be more antitrust cases that could result in more divestitures.

The Congress was not responsible for the AT&T divestiture, but it will surely bear some of that burden if the BOCs disadvantage competition (as they have the potential to do) as a result of the passage of S. 2565.

There is no need or good reason for S. 2565 at this time. Instead, we believe that Congress should focus on the transitional rules and policies needed to bring about real long distance competition.

My company is spending about two billion dollars to build the highest quality state-of-the-art long distance network in America today. Yet the quality of calls over our fiber optic network is degraded because our customers still must originate or terminate many of their calls through local exchanges where we are provided inferior access.

Moreover, there is a long list of unfair disadvantages including marketing handicaps, continuing unequal access, balloting disasters, failures to hook-up customers, and other problems that have made the last few years a phenomenal uphill battle for us and other competitors to bring the benefits of real competition to the public.

I am proud of what my company has been able to accomplish despite these problems; but the fact remains that these problems still exist and will continue to hinder the development of free, full, and fair competition unless Congress acts. Competition—and the choices in price, features and quality that it afford the consuming public—should be the priority public policy goal.

S. 2565 does not address any of these critically important issues. S. 2565 is probably unconstitutional and clearly not in the public interest. I urge this Committee to reject S. 2565.

Thank you very much. I would be pleased to answer any questions that you may have.

[The statement follows:]

STATEMENT OF CHARLES M. SKIBO, PRESIDENT, U.S. SPRINT COMMUNICATIONS CO.

Thank you, Chairman Danforth, and distinguished members of the Senate Commerce Committee for the opportunity to present this testimony. The telecommunications industry has suffered in recent years from a lack of certainty in the rules guiding the conduct of regulators and participants. American consumers have suffered because of an apparent weakening federal commitment to allow competition to fully develop in long distance telecommunications markets.

There has not been a lack of rules; rather, there have been too many constantly changing rules. And in too many instances those changes have not promoted a reasonable transition to full competition, but instead retarded it.

For these reasons, my company has consistently advocated Congressional guidelines to send a clear message to the regulatory authorities to promote competition, so that we can all know what the rules will be and operate our businesses to provide service to the public accordingly.

Thus, we are both pleased and privileged to appear before this Committee to contribute to a solution to these dilemmas.

I must begin, however, by saying that the focus of these hearings—S. 2565, the "Federal Telecommunications Policy Act of 1986"—is not the solution. There are many critical issues which Congress could and should address if it is prepared to finally establish a comprehensive "Federal Telecommunications Policy". I do not believe that modifying both the decision-making process and the substance of restrictions on some activities of seven regional Bell Operating Companies (BOCs) is either the only telecommunications policy issue on which Congress should focus, or even the most important one.

The recent "Danforth proposals" address only some of the problems with the narrow issue of the BOC restrictions raised by S. 2565. Instead of trying to provide simple legislative solutions by giving the FCC broad, but totally unenforceable, policy mandates, those proposals demonstrate just how complicated this set of issues are by starting to ask some very hard questions.

I want to praise the way you, Mr. Chairman, and others on this Committee are proceeding. You have not accepted at face value the assertion that this legislation was a simple, limited action, with simple, understandable consequences. You have not been rushed into hasty legislative decisions driven by arguments that the public interest required emergency intervention.

You have not accepted the simpistic argument that this bill is only procedural. Your proposals recognize that the FCC is prepared to take action if it is given the authority to do so—but that Congress must direct that action, that it must make the critical decisions itself.

Each step of your process is uncovering more and more of the complex questions which permeate this matter. There are *no* easy substantive or procedural answers. And until recently, the questions were not even being asked. As you have started to ask those questions, you have been criticized by some for "moving too slowly". There will be more of that. But you should continue to ignore such self-serving attacks. You have the power to help or hurt the American public and the American economy in very significant ways, depending on how you proceed. The public deserves nothing less than a full, deep, and careful inquiry and debate before you act.

U.S. SPRINT

I would like to, first, briefly tell you about my company so you may better appreciate our significant interest in federal telecommunications legislation. U.S. Sprint Communications Company (U.S. Sprint) is a New York general partnership headquartered in Kansas City, Missouri. U.S. Sprint was formed effective July 1, 1986, by combining the interexchange telecommunications assets and businesses of U.S. Telecom, Inc. (a subsidiary of United Telecommunications, Inc.) and GTE Sprint Communications Company (a subsidiary of GTE Corporation). Our operations involve nearly 9000 employees throughout the United States providing service to almost 3.5 million customers. Based on gross revenues, U.S. Sprint serves a little over 4% of the national long distance telecommunications market. We are well into the second year of construction on the first nationwide all-digital fiber optic network that, when completed in late 1987, will span approximately 23,000 miles and have a point-of-presence in every local access and transport area (LATA). As of the end of August, we have completed construction on just over 10,000 miles. The costs to construct this nationwide network are enormous—requiring an investment of about $2 billion—but, the state-of-art technology being employed will enable U.S. Sprint to offer the consuming public the highest quality service with a wide variety of features at the lowest cost.

Yet, our efforts, our investment and our ability to provide competitive services to the public have been repeatedly hindered by federal policies which have not promoted competition, and in many cases affirmatively threatened it.

I would also like to briefly set forth my qualifications. I hold a bachelor of science degree from the University of West Virginia. I began my professional career in 1960 with the Exxon Corporation and worked in sales and marketing, market development, corporate planning, operations and general management. In 1979, I joined

MCI Communications Corporation. I held several senior executive positions with MCI, including president of MCI Southeast. In April, 1985, I joined U.S. Telecom, Inc. as president. On July 1, 1986, I became president of the new U.S. Sprint.

S. 2565

S. 2565 would shift the responsibility for administering, enforcing and modifying the AT&T consent decree from the U.S. Department of Justice (DOJ) and Judge Greene's court to the Federal Communications Commission (FCC). It embodies the much-discussed concept of permitting the expert federal agency to deal directly with complicated telecommunications issues.

While my company generally agrees with the fundamental concept that the FCC is the appropriate agency to regulate telecommunications, I respectfully submit that telecommunications expertise is not the fundamental question here because the AT&T consent decree does not involve exclusively telecommunications issues.

Antitrust enforcement.

The AT&T consent decree resulted from an antitrust case brought by the DOJ in 1974, and its enforcement involves the resolution of some very significant antitrust issues. The federal court and the DOJ are clearly the appropriate federal agencies to deal with these antitrust issues. It would be both legally improper and substantively counterproductive to strip them of that authority.

In that regard, the threshold issue of the constitutionality of S. 2565 cannot be ignored. The Constitution mandates that the courts shall be free to undertake their judicial responsibilities without supervision by any other branches of the government. Thus, the proposal in S. 2565 to transfer administration of the AT&T consent decree to a regulatory agency appears to be an improper encroachment on the independence of the federal judiciary and a violation of the constitutional doctrine of separation of powers. Please understand that I do not hold myself out to be an expert on such matters; but, it is apparent to me that the experts should address and resolve the matter of the constitutionality of S. 2565 before it is considered further.

The AT&T consent decree, and its restrictions to be enforced by the court, was not an accident or some arbitrary action by an uninformed judge. The AT&T consent decree settled a long standing antitrust case against AT&T and the Bell Operating Companies in which the government had clearly demonstrated the wide-spread anti-competitive practices used by the telephone monopoly against its would-be competitors. The AT&T consent decree was designed to uphold U.S. antitrust law and prevent future abuses of monopoly power by the local telephone companies. When the circumstances that gave rise to the anti-competitive practices have changed, and not before, the court—not the FCC—should change the restrictions in the consent decree.

On the other hand, the FCC—not the court—is making national telecommunications policy. The FCC is deciding equal access rules and prices, allocation of NTS costs, depreciation, accounting, competitive entry, lifeline, high cost support funds, rate of return, bypass, and on and on. It is only on the narrow question of whether seven companies—the BOCs—can escape an antitrust decree and diversify that the Judge is playing a central role.

It should also be noted that most of the seventy-plus line-of-business waivers that Judge Greene has granted to the BOCs to date involve business activities that have only a tangential relationship, if any at all, to local telephone service—like real estate ventures, consulting services, offshore manufacturing, computer software development, etc.—and that the FCC has no particular expertise to pass upon the propriety of such ventures. Moreover, all of these ventures have been structured by the BOCs separately from their local telephone operations and, as non-regulated activities, their profits (if any) benefit only BOC stockholders—not ratepayers.

The pressure to modify the consent decree

Have circumstances significantly changed since divestiture?

The BOCs continue to dominate all segments of the local telecommunications market. There are no new competitive threats which could provide an alternative to the local telephone company. The BOCs' absolute bottleneck control of local communications traffic has not declined measurably in just the last two years.

The only area where there is some competition is in access to long distance, but even the FCC admits that most so-called bypass is carried by the BOCs themselves on their own private lines. This then is a tariffing problem, not a competition question.

A recent antitrust case involving intrastate long distance competition serves as a reminder of the BOCs' local bottleneck status and their willingness to use it to their advantage. A review of the extensive testimony given to Judge Greene can also provide a powerful refresher course on why the antitrust suit was filed in the first place, and how little has changed at the local level since it was settled in 1982.

Competition in long distance is fragile due to AT&T's enormous original and continuing dominant market power, and due to unfair and unreasonably rapid deregulatory policies of the FCC. The little competition we have can be destroyed by recreating the circumstances which retarded and weakened long distance competition in the first place.

A public interest standard

If circumstances have not significantly changed since divestiture, but these seven companies are still to escape restrictions to which they and the court so recently agreed, they must bear the burden of proof that the public interest will be served.

If, in fact, consumers are being deprived of new services and products by the AT&T consent decree restrictions, or those restrictions impose significant costs on the economy, then we should address changes. However, evidence of that kind is not driving this debate.

If it can be shown that national public telephone networks and services are being harmed by excluding the BOCs from long distance, information services or manufacturing, then telecommunications concerns are clearly involved. No such showing has been made.

If it can be shown that universal telephone service at reasonable rates will be enhanced by modifying the AT&T consent decree, or harmed by a failure to do so, then telecommunications concerns are clearly involved. No such showing has been made.

If new technologies and services are being denied to users and the economy by the AT&T consent decree restrictions, then telecommunications concerns are clearly involved. No such denial has been shown.

Yet it has been claimed that BOC entry into new markets would make available new and lower-priced services and technologies to consumers, although very little has been said about what services and technologies these might be, or how the BOCs could provide them more cheaply than existing competitors have been able to.

There has been no evidence of the public interest that would be served by modifying the consent decree. Before you act on S. 2565, you should insist on it.

THE DANFORTH PROPOSALS

I would specifically like to address the substantive issues raised by S. 2565; I believe this can be most productively accomplished by following the format of the Danforth proposals.

I. Findings.

We, of course, agree that competition in long distance telecommunications is preferable to government regulation in the long-term. But that is really not the critical regulatory policy issue. The critical issue is what role must the government play *now* to ensure that we complete the transition from monopoly to full competition in long distance.

We have argued repeatedly before both the FCC and Congress that a reasonable and well-managed transition to competition is absolutely essential to the ultimate survival of competition in this market. After a very promising start, we have been very disappointed—and our efforts to bring the benefits of competition to the public have been significantly hindered—by federal regulatory policies and decisions which have not recognized the crucial distinction between a market being opened to competition, and a market being genuinely competitive and therefore appropriate to deregulate.

Our position was best stated by William T. Esrey, President and Chief Executive Officer of United Telecommunications, Inc., before the hearings on issues in the competitive long distance telephone industry held by the Subcommittee on Communications of the Senate Commerce Committee on September 5, 1985. I would respectfully urge the members of this Committee to review that testimony.

In summary, Mr. Esrey urged Congress to consider legislation which would compel the FCC to (1) recognize that today the interexchange long distance market is not competitive, (2) perceive the critical state of development of the interexchange industry and the significance and enormous expense of current efforts to develop full, competing national transmission facilities, (3) acknowledge the continuing market domination of AT&T, (4) cease its ongoing attempts to de facto deregulate AT&T by eviscerating the tariff review process, (5) account for the significantly lower use value of Feature Group D (supposedly "equal") access to competitive carriers, and (6) develop a practical plan to promote the development of full competition in long distance to permit the realization of the consumer benefits sure to result from it.

Make no mistake about it. There are some serious problems with the development of full competition in the long distance telecommunications market. We believe that the public will gain significant benefits if you address those problems.

Our company responded to the federal call for competition. We thought you meant it. We could see how the public would benefit. Yet neither the Congress nor the FCC has consistently followed through by promulgating and enforcing the transitional rules and policies needed to bring about real long distance competition.

My company is spending about two billion dollars to build the highest quality long distance network in America today. Yet the quality of calls over that state-of-the-art optical fiber network is degraded because our customers still must originate or terminate many of their calls through local exchanges where we are provided only inferior access.

It must be recognized—and reflected in access charge rate structures—that the lack of universal equal access severely disadvantages AT&T's competitors. Competitive carriers should not be forced to pay the same rates for access as does AT&T when they are forced to accept inferior connections.

Moreover, the long list of unfair disadvantages including marketing handicaps, balloting disasters, failures to hook up users who selected us, and continuing unequal access, have made the last few years a phenomenal uphill battle to bring real competition to the public. I am proud of what we have accomplished despite these problems and the enormous embedded market power of AT&T, but we could have done so much more if the rules had been fair.

Yet whenever I raise these issues I often hear charges that we are looking for a subsidy. It distresses me, but in the real world in which I live, I know that my company is not looking for a subsidy. I do not want special treatment or favors for my company; I do want to see full and complete competition in the long distance telecommunications market, a valid public policy goal that seems to have been forgotton.

S. 2565 does not address any of these critically important issues. It is not a bill to further national public policy goals, like full competition in the long distance telecommunications market.

II. Petitions for waiver, modification, or elimination of current restrictions

Because the restrictions on the Bell operating companies imposed by the AT&T consent decree were put in place for antitrust reasons, we do not believe it is appropriate to empower the FCC with the authority to waive, modify or eliminate them. As I discussed at length above, what is involved here are economic antitrust issues, not telecommunications issues.

The FCC has no particular antitrust expertise; that is an area properly enforced by the DOJ and the courts. If the FCC were to eliminate a restriction that still had antitrust ramifications, the matter would surely be brought back to the federal court for ultimate resolution; and, nothing will have been accomplished except, perhaps, for a prolonging of the debilitating uncertainty that now pervades our industry.

My company is, of course, primarily concerned about the restrictions in the AT&T consent decree prohibiting the BOCs from entering the information services and long-distance (interLATA) telecommunications markets. I think it would be helpful for this Committee to understand why those restrictions were put in place.

For more than a decade prior to divestiture, the BOCs opposed long distance competition. Even after the courts forced them to give competitors access to the local exchanges, they gave AT&T access to the local loop which was far superior to that permitted for AT&T's competitors; indeed, that was one element of the unfair discrimination that gave rise to the antitrust case against AT&T.

The DOJ and Judge Greene also recognized the potential for this situation to recur and, for that reason, prohibited the BOCs from providing long distance service, thereby removing any incentive to again discriminate in favor of themselves. In other words, the BOCs could not recreate "little AT&Ts", at least until their monopoly control over the local exchange "bottlenecks" was eliminated.

Then, to bring a rapid end to the most obvious form of discrimination, the DOJ and Judge Greene required the BOCs to provide interexchange competitors access to the local exchanges that was the same as that enjoyed by AT&T.

Some people will argue that the BOCs no longer have monopoly control over the local exchanges; but, the facts clearly prove otherwise. Whether it is in Washington, D.C. or Wichita, Kansas, you cannot order standard local telephone service from anyone except the local telephone company, usually a BOC. Some people will also argue that as of September 1, the BOCs are now providing equal access everywhere; but, again, the facts are contrary. Only about 70% of the local access lines in the United States have been converted to so-called "equal" access and, according to reports filed with Judge Greene on August 1, 1986, many areas will not be fully converted until the mid-1990s. And, we are not talking about rural areas; significant parts of major metropolitan areas—such as New York City and Boston—will not have equal access service for several years.

Thus, even the *first* major step towards *allowing* fair long distance competition is a long way from being completed. And that is only for *interstate* long distance. There is no requirement that the BOCs provide equal access for *intrastate* long distance, and in many cases they do not. In fact, in some states competitors are effectively totally excluded from intraLATA long distance competition. These issues should be addressed before there can be any discussion of either deregulating AT&T or allowing the BOCs into the long distance telecommunications market.

III. FCC regulations

The Danforth proposals contain directions for FCC regulations to safeguard new competitive ventures through auditing procedures, disclosure of information, nondiscriminatory access and structural separations.

We believe all of the safeguards, and many more, would be necessary if the jurisdiction over the AT&T consent decree were transferred to the FCC and the FCC decided to waive, modify or eliminate any of the restrictions; but, as previously noted, we do not believe, based on antitrust considerations, the FCC should be empowered to alter the AT&T consent decree restrictions.

In that regard, the Committee should recognize that all of the proposed safeguards are designed to protect against essentially the same abuses which prompted the restrictions contained in the AT&T consent decree. Thus, you must ask yourself these questions: Why replace proven restrictions with an elaborate set of untested regulations? Moreover, aren't such exhaustive regulations inconsistent with the eventual goal of lessening government intervention? Do not new regulations which would replace known and established restrictions only add to the uncertainty already prevalent in the industry?

We submit for both legal and pragmatic reasons that the restrictions contained in the AT&T consent decree must remain unaltered and their enforcement left to the DOJ and the courts.

The Danforth proposals also contain suggested additional provisions pertaining to specific lines-of-businesses. First, there is the question as to whether telephone companies should be allowed into the long distance market only if there are no legal barriers to entry into the intrastate toll market. We believe this proposal addresses the very same "bottleneck" issue as discussed above. That is, the BOCs cannot and should not be permitted to leverage their monopoly positions in the intrastate (interLATA) markets to gain an unfair competitive advantage in the interstate (interLATA) market.

If the BOCs were permitted to enter the long distance telecommunications market under current circumstances, they would have the ability to effectively and structurally recreate the predivestiture Bell System; the same antitrust problems that resulted in the divestiture in the first instance would reappear with likely the same consequences.

IV. Other amendments

The Danforth proposals appropriately raise the issue of the involvement of state regulatory bodies in the deregulation process. We fully agree that the states must be involved in the process and believe the Federal-State Joint Board is a workable vehicle to accomplish that involvement. The goal of such federal-state joint efforts should be to achieve a higher level of national policy uniformity on deregulation issues. Congress can surely appreciate the need for uniformity between and among the states and the federal government in the regulation of national endeavors such as the provision of long distance telecommunications services, and should properly encourage such in any legislative initiative.

The final question posed in the Danforth proposals pertains to the continuing authority and effectiveness of the DOJ. Despite the rather radical shifts in position by the Antitrust Division on these questions recently, the thrust of my testimony has been to support the continuing jurisdiction of the DOJ and the federal court over the antitrust enforcement of the AT&T consent decree. We believe the DOJ and the court are the only proper bodies with the expertise and experience to monitor and enforce compliance with the letter and spirit of the antitrust settlement. They have done an admirable job to date and should not be stripped of authority. As stated earlier, the FCC should and does have the primary authority to deal with telecommunications issues; but, the AT&T consent decree is clearly and primarily an antitrust matter.

In conclusion, I urge the Senate Commerce Committee to reject S. 2565. It is probably unconstitutional and clearly not in the public interest. Further, I respectfully submit that Congress should address more pressing telecommunications issues, such as AT&T's market dominance, providing for deregulation only when full, fair and non-discriminatory competition in long distance telecommunications services exists, providing for appropriate access charges that reflect the lesser value of local connections furnished to competitive carriers on a LATA-wide basis, and mandating the ubiquitous provision of equal access by the BOCs to every competitor everywhere that AT&T presently enjoys it. I believe that only with these measures can we be assured that competition will have an opportunity to succeed and provide the benefits of choice, higher quality, and lower prices to the consuming public. Thank you very much.

[The following information was subsequently received for the record:]

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. What do you think of the idea of allowing the BOCs to provide interstate long distance services if competition exists, or is not legally barred, in intrastate long distance services?

Answer. Permitting intrastate long distance competition would not address the critical concern about BOC entry in interstate long distance services, namely the local exchange bottleneck. Because the BOCs control the local exchange network, long distance companies are dependent on them to provide access to this network in a pro-competitive, nondiscriminatory fashion. It is because the Bell System local exchange companies abused their monopoly hold on local access to the detriment of competition that the MFJ and the line of business restrictions have been imposed. As long as the BOCs remain the monopoly providers of local exchange service and access, the line of business restrictions should remain in place. To do otherwise would place the ongoing development of the competitive telecommunications industry in serious jeopardy.

Question. Have the Bell companies satisfied the equal access requirements of the AT&T divestiture decree?

Answer. According to the terms of the MFJ, the BOCs are required, subject to limited exceptions, to provide all interexchange carriers access for all access services that is equal in type and quality to that provided to AT&T and its affiliates. While the equal access conversion processes is underway, U.S. Sprint is far from having ubiquitous equal access for all access services that is equal in type and quality to that provided to AT&T. The equal access conversion process was to have been substantially completed on September 1, 1986. However, it is clear that there are still substantial deficiencies that, while arguably legal, nevertheless hinder the achievement of full, fair competition envisioned by the MFJ.

To meet the equal access requirements of the decree, equal access must be made available in all end offices except in those very limited cases where the cost of conversion so outweighs the benefits as to make the conversion unreasonable. This requirement notwithstanding, NYNEX will have converted only 75% of the access lines in southern and midtown Manhattan by December 31, 1986. Full conversion of the lines in Manhattan will not occur until the end of 1990. In metropolitan Boston, only 78% of the lines will be converted to equal access by December 31, 1986; full conversion will take two more years. Ubiquitous equal access in the NYNEX territory will not be completed until the end of 1992 at the earliest.

This problem is seen in other regions as well. Ameritech had converted between only 78 and 89 percent of its access lines in major metropolitan areas by September 1, 1986. Bell Atlantic will not convert all of its offices until 1989 and 10% of the access lines remain unconverted to equal access in Bell South's major metropolitan areas.

There are also services other than one-plus dialing where U.S. Sprint does not yet have access equal to that of AT&T. An example of this would be 800 service. While AT&T has the same high-quality 800 service access it has always had, competitors receive a type of 800 access that is inferior to AT&T's. This inferior access is acknowledged as an interim service but the fact remains that 800 access equal in type and quality to AT&T will not be available to competitors until 1988.

Until equal access is available nationwide and for all service offerings, competitors of AT&T will remain at a severe disadvantage. While it has not yet been determined that, as a matter of law, the BOCs have failed to comply with the equal access requirements of the Consent Decree, it is true that there are many geographic and service areas where U.S. Sprint does not yet have access equal in type and quality to AT&T's. The sooner we have such access the sooner we will be able to realize the same operational and strategic benefits in interconnection to the local exchange which AT&T currently enjoys, and the sooner the benefits of true competition will reach every phone user in the country. Anything short of full conversion to equal access disadvantages competition and the benefits it brings to the consuming public yet, today, full conversion remains several years away from becoming a reality. In this regard, the BOCs have failed to meet the equal access requirements of the MFJ.

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question. What effect on long distance competition would result from a removal of the ban on BOC participation in those services? Would equal access and separate subsidiaries eliminate your concerns?

Answer. The line of business restrictions, including the long distance prohibition, were designed to prevent recurrence of recent anti-competitive activity by the Bell System. Removal of the ban on BOC participation in long distance services would undoubtedly result in the same type of anti-competitive conduct that precipitated divestiture, irreparably damaging the competitive telecommunications system that is currently emerging.

In order to provide long distance services, competitors must have access to local facilities controlled by the Bell Operating Companies. One of the primary violations alleged in the AT&T antitrust case was manipulation of this local monopoly "bottleneck". The Bell System local exchange companies were found to have granted preferential treatment to AT&T, their long distance business, in an effort to retain monopoly control and thwart the development of a competitive telecommunications marketplace. It should be noted that this anti-competitive conduct took place in spite of the total regulation imposed on the Bell System by the FCC at that time. As long as the BOCs control the local bottleneck to which long distance competitors require access to provide their services, the prohibition on BOC participation in long distance services should remain in place. Otherwise, the circumstances which preceded divestiture will arise again with similarly troublesome results.

Equal access is not a solution to the bottleneck problem. While equal access does afford competitive long distance companies some of the advantages that AT&T has by virtue of its prior monopoly position, it is not a solution to the monopoly hold that the BOCs maintain on the local network. The problem with BOC entry into long distance is the existence of incentive plus capability to use the monopoly control over local service to the disadvantage of would-be competitors in the long distance marketplace. Equal access results in automatic number identification, rotary dial access, one-plus dialing and so forth but it does not ensure nondiscriminatory access to the local network or protect against cross-subsidization or predatory pricing schemes. Only the BOCs can do that and, therefore, they should not be granted the incentive to act anti-competitively to the detriment of the telecommunications marketplace.

Separate subsidiaries do not eliminate the problems associated with BOC entry into the long distance market either. It is naive to assume that simply establishing separate subsidiaries eliminates the desire or the ability to leverage one side of a business to the advantage of another. While separate subsidiaries are more effective than non-structural safeguards, BOC entry into long distance prior to the existence of alternative access providers at the local level remains tantamount to re-establishing the same conditions that existed prior to, and resulted in, divestiture.

Question. In your view, will a shift of decree oversight powers from the court to the FCC help or hurt local ratepayers, long distance ratepayers, or other consumer groups?

Answer. In my opinion, competition and the choices in price, features, and quality that it affords the consuming public should be the priority public policy goal. A shift of decree oversight from the Court to the FCC will not foster this goal and, in fact, will almost certainly result in harm to telephone ratepayers. The antitrust laws exist to protect the public from exploitation at the hands of monopolists. While the FCC is the proper agency to decide telecommunications policy, it is not the proper body to enforce antitrust consent decrees.

In 1982, in its statement to the Court explaining the MFJ, the Justice Department described a "regulatory alternative" that would have relied solely on FCC regulations to protect consumers and prevent anti-competitive conduct by the BOCs. The Justice Department found this alternative inadequate and stated, ". . .it would have required detailed and extensive monitoring and would have imposed substantial costs on AT&T and the United States. Most importantly, this 'regulatory' alternative would have been far less certain than the proposed [consent decree] to achieve an environment. . .that would promote vigorous and effective competition".

To date, this FCC has not shown itself to be effective at protecting consumers from cross-subsidization, predation, or discriminatory pricing schemes at the hands of AT&T or the BOCs. Recently, Pacific Telephone was found to have appropriated approximately $13 million dollars from its local ratepayers to subsidize so called "competitive" ventures. It appears that the FCC is less inclined than the court to adopt preventive measures, waiting until consumers have been harmed rather than preventing foreseeable problems beforehand. The line of business restrictions contained in the MFJ exist to protect both consumers and competition; absent those restrictions, the BOCs—with their control over the local exchange bottleneck—would have the incentive and the ability to raise local rates for basic service and discriminate against competing providers of long distance services.

While it is clear that local ratepayers would be harmed through cross-subsidization and rate discrimination, it is also likely that long distance ratepayers would suffer. Should the FCC obtain oversight jurisdiction and remove the line of business restrictions (which they certainly would do) while the BOCs maintain monopoly control over local access facilities, competition would be seriously damaged. To date, competition in the long distance market has resulted in lower long distance rates to consumers as well as dramatic technological advancements such as U.S. Sprint's nationwide fiber network which is currently under construction. Should competition in this market be destroyed, not only are more divestitures likely but long distance rates will surely rise again.

The CHAIRMAN. Thank you, Mr. Skibo.

Mr. Vasilakos.

Mr. VASILAKOS. Mr. Chairman, thank you for the opportunity to express the views of ALC Communications on S. 2565.

We are the third-largest competitive long-distance company in the Nation serving approximately 500,000 customers throughout the United States. ALC differs from the other long-distance companies represented on this panel in that it is not affiliated with a large information technology or local telephone company.

We are opposed to S. 2565, and in the brief time allotted here I would like to highlight four critical points concerning the implications of this proposed legislation for long-distance competition.

First, because of their local monopoly the BOCs would have an insurmountable competitive advantage over every long-distance carrier. They exercise classic monopoly control over the ability of virtually every one of my customers to access our long-distance network. The BOCs have perfect information on all long-distance traffic originating in their territories, and they can use that information to optimally size and design their networks and target their marketing efforts.

If they are permitted into the long-distance business, they will have everything they need to know about their competitors' customers. The BOCs control when my company can have needed access services installed, how quickly those services are fixed when they fail, and how they are priced. If this legislation passes, the BOCs will be the only companies able to provide one-stop shopping for equipment, local service, long-distance service, and information services.

The BOCs will have all these advantages solely because of their unique positions as local monopolists, advantages their competitors can never have. The free enterprise system will not thrive when some players possess such powerful and unearned advantages.

Secondly, the fact that Congress is considering this legislation is having an effect in the capital markets. As I mentioned, unlike U.S. Sprint and MCI, ALC is not affiliated with any large corporation. We have to seek the capital we need in our business from the general capital markets. Additionally, ALC is not constructing its own national network; rather, it obtains a large part of its intercity transmission capacity from an emerging industry segment of wholesale transmission suppliers.

Wall Street fully recognizes the dramatic competitive advantages the BOCs would have in entering the long-distance market while they possess their local monopolies, and I am convinced that passage of this bill will have a substantial chilling effect on the ability of new competitors and the new wholesale transmission industry segment to capitalize their businesses.

Thirdly, Mr. Chairman, my experience tells me that creating regulations to limit competitive abuses affecting long-distance service will not work. Such rules are not enforceable. Past FCC efforts to enforce adopted cost allocation procedures intended to eliminate cross-subsidies were abandoned, and there are other serious issues that do not lend themselves to solution by regulatory fiat.

For example, I do not believe there is any regulation can effectively prohibit John Smith who may work in a BOC's long distance division from obtaining critical customer usage information maintained by his long-time friends in the access service division. The incentives for the BOCs to take advantage of their local monopolies are simply too strong, Mr. Chairman. If FCC regulation was workable, we probably never would have had the divestiture in the first place.

Fourth, our attorneys advise that S. 2565 is constitutionally unsound. Further, while the bill is being characterized as strictly a procedural step, it will effectively amend the antitrust laws as they are applied to the telephone business. If Congress wishes to exempt the telecommunications industry from the antitrust laws, it should do so explicitly.

I do not believe Congress should disguise the antitrust issues, nor should it pass legislation of questionable constitutionality which will be litigated for years and add to the uncertainties in this business.

In conclusion, I think it would be unwise to enact S. 2565. It is premature. The MFJ is working. Competition is developing. The BOCs' earnings have been excellent. We are beginning to have normal customer-supplier relationships with the BOCs. The environment is improving dramatically over that prior to the divestiture when the BOCs, as part of AT&T, were both our competitors and our suppliers of monopoly access services and had a fundamental conflict of interest.

I urge you not to prematurely change once again the basic structural rules for the telecommunications industry when progress is being made. The benefits to the consumers that are just becoming apparent will be lost. Thank you.

[The following information was subsequently received for the record:]

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. What has changed since divestiture that prevents the BOCs who control local monopoly facilities, from discriminating against other long distance carriers?

Answer. Very little has changed that would limit the BOCs ability to discriminate against long distance companies with which they might compete. Although the BOCs have deployed Feature Group D access service—their definition of equal access—in many locations, the advent of Feature Group D does little to diminish their bottleneck control over local access. For ALC, 100 percent of the access services used in BOC territories is provided via BOC facilities. While there is much rhetoric about bypass technologies, as a practical matter there are no real bypass alternatives available to serve ALC's customers. ALC must rely on the BOCs.

Because ALC is totally dependent on the BOCs for access service, their leverage over ALC's operations is tremendous. As I indicated in my testimony, the BOCs control what facilities are available, when they can be delivered, how they are priced, and how quickly they get fixed when they fail. That Feature Group D has been deployed in some locations has no diminishing affects on this problem. The BOCs are still the sole suppliers of Feature Group D.

That the BOCs continue to use their market power to their best advantage in the post divestiture environment is illustrated by the following examples:

The equal access conversion process was designed by and for BOC interests, not in the interests of increasing competition. The BOCs originally scheduled office conversions that suited their administrative needs without regard for the inefficiencies in network management or marketing that the schedule created for competing long distance companies. The balloting and allocation process was established late in the game by the FCC only after pleas from new competitors demonstrating the inequities of the original BOC plan. The BOCs were then in control of the procedures for the new process, and long distance companies had to design their information systems to BOC specifications and argue, after the fact, for modifications to BOC specifications.

The BOCs control the configuration of the interexchange carriers' local networks. They decide on the routing and type of facilities used to provide access services based on their own network considerations. This control can be used to reduce efficiencies of an interexchange carrier's network by requiring increased investments by long distance companies in their points of presence that would otherwise be unnecessary.

The BOCs control of access pricing influences how intercity networks are configured. For example, the distance sensitivity of local transport access rates influences where a long distance company locates its points of presence in a LATA. The BOCs have the power to induce long distance companies to relocate their points of presence or incur additional costs just by manipulating the rate structure for access services.

The BOCs control the billing of access services. For nearly two years after divestiture they were totally unable to accurately bill using a rating formula that they devised and represented to the FCC as necessary in the provision of nonpremium access services. As a result, all interexchange carriers other than AT&T had to guess at their access costs. Because access service is the largest operating expense, an error in access costs of only a few percent can mean the difference between profitable and unprofitable operations. Billing accuracy remains a serious problem, and the BOCs ability to disrupt the financial operations of long distance companies is significant.

Even where full competition is allowed, BOC monopoly control allows them to discriminate against their competitors. For example, in Ohio, the Public Utility Commission has authorized toll service competition statewide, including intraLATA competition. But Ohio Bell continues to keep all 1+ (equal access) traffic for itself, claiming that the P.U.C. has not specifically required it to give up its toll monopoly.

NYNEX now has a proposal before the FCC which would force customers to accept a new dual billing system for long distance calls. Customers would receive one bill for originating access costs and a separate bill from their long distance carrier for the remaining portion of the same calls. The customer confusion resulting from the scheme would be extreme. Long distance companies could avoid having their customers confused by purchasing NYNEX billing services. Under this scheme NYNEX would be the only source of complete billing. Even if the FCC rejects this proposal, NYNEX's plan demonstrates that the BOCs have both the incentive and the ability to use their monopoly control over access services to the disadvantage of competing long distance providers.

The BOCs are now attempting to gain entry into the operator services market. Some access services such as Feature Group B are substitutable for credit card operator services. If the BOCs are allowed to enter, they can pressure long distance companies to use their operator services by limiting the availability of Feature Group B or other substitutable access services in their operating territories.

In summary, there has been little change in the level of control the BOCs exercise over long distance companies. Senator Gorton asked me at the hearing whether the BOCs have learned anything from the divestiture experience. Upon reflection, I think the appropriate answer is yes. They have learned that they must be more careful so that next time they won't get caught.

Question. What role should state regulators have regarding intrastate long distance? Should they get specific powers under any legislation?

The FCC cannot regulate purely intrastate long distance today. Would or should legislation give them the power to do so?

Answer. As a conceptual matter, the jurisdictional separation between state and interstate regulation of long distance services is an inappropriate structure when a national policy exists promoting competition in those services. The diverging policies of the states create barriers to entry and exit for long distance companies and create pricing distortions that cause inefficient network investments. For these reasons, ALC supports the notion that jurisdiction over all toll services should be shifted to the FCC. However, as a practical matter, the states have real policy and service issues that must be considered such as the level of subsidy intrastate toll service contributes to local service. A shift to the FCC would take away a states ability to manage the transition to cost based local rates considering local conditions. For this reason ALC suggests consideration of a shift in jurisdictional authority in five years in order to give the states a transition period to adjust their pricing policies for local service.

Question. What do you think of the idea of allowing the Bell Companies to provide interstate long distance services if competition exists, or is not legally barred, in intrastate long distance services?

Answer. The question implicitly and improperly assumes that the primary obstacle to creating a fair competitive environment for long distance services that includes the BOCs is the lack of authority of existing long distance companies to fully compete on an intrastate basis. The fundamental issue that must first be addressed is BOC monopoly control over access services. As I stated in my testimony, unless and until that control is eliminated, the BOCs should not provide long distance services because they will have advantages no other long distance companies can obtain and against which no other long distance companies can effectively compete. Full intrastate competition for long distance services is a necessary but not sufficient condition for allowing BOC entry into interstate long distance markets.

Question. Have the Bell Companies satisfied the equal access requirements of the divestiture decree?

Answer. The Modified Final Judgement requires that the BOCs provide access that is equal in type and quality as that provided to AT&T. Such access is not yet meaningfully available to AT&T's competitors; however, as a technical matter it does not appear that the BOCs are in violation of the consent decree.

When the BOCs entered into the consent decree their obligation was broadly interpreted to require that all forms of access were to be equal. However, as the process for implementing equal access evolved, it became clear that availability of equal access would occur in stages. For example, it was widely perceived that on September 1, 1986 the equal access transition would be over and the process completed. Now that the date has passed, it is clear that the process is only half-way to two-thirds of the way completed. Because the BOCs identified so many locations subject to the exception criteria of nonconforming switches, only approximately 55 to 70 percent of the subscriber lines have equal access capability, depending on the region of the country. For ALC, only approximately 63 percent of the subscriber lines in BOC territory of its serving LATAs had equal access capability as of September 1,

1986. Thus, it cannot be said with respect to the availability of high quality, "1+" access service that ALC can obtain access equal to that of AT&T. The number of subscriber lines not yet affected by the deployment Feature Group D is much larger than generally expected.

The conversion process to date, though, has focused on only one kind of access—that used by MTS customers. Other forms of access are still unavailable to ALC. The leading example is 800 Service. The BOCs are just beginning to make available to ALC an inferior form of 800 Service access. Access arrangements that are substantially equivalent to those AT&T now receives will not be available until 1988. Such late deployment is a consequence of Court interpretations of the consent decree in which AT&T was allowed to maintain possession of the data base and related systems needed to operate 800 Service. The BOCs have to develop those systems themselves. Thus, while the BOCs are not in violation of the decree, they have not completed their obligations as they relate to a market segment that is currently worth $4-5 billion and is one of the fastest growing long distance markets.

In short, the BOCs have not disposed their MFJ obligations. They have met the schedule of events thus far as imposed on them by the Court. Equal access for 1+ use will not be fully available until the early 1990's. 800 Service equal access is still several years away. AT&T maintains a monopoly on public phone operator services. The BOCs continue their monopoly hold on 1+ intraLATA access even where competition has been authorized. There is much that the BOCs must complete before it can be said that they have satisfied their equal access requirements.

The CHAIRMAN. Thank you, sir.

Mr. MacAllister.

Mr. MACALLISTER. Thank you, Chairman Danforth, and Members of the Committee, for the opportunity to present U.S. West's views on the Federal Telecommunications Policy Act of 1986.

My message here today is simple and direct: S. 2565 should be enacted into law. U.S. West stands ready to argue the merits of the MFJ's line-of-business restrictions in the open process that the Communications Act, the Administrative Procedures Act, and judicial review provide. We will discuss all constructive proposals for removing the line-of-business restrictions and for public interest safeguards, such as those proposed when these hearings were announced.

The public interest lies in the speedy resolution of these issues, and we stand ready to assist the Committee in that effort. Although S. 2565 as introduced by Senator Dole does not go to the merits of retaining or removing the line-of-business restrictions, U.S. West believes the public interest requires that the restrictions be removed.

Over the past decade one aspect of telecommunications policy has become clear: the public's telecommunications needs are best served by competition. The modification of final judgment dramatically reduces competition by placing unnecessary and counterproductive restrictions on the divested Bell companies. These companies constitute fully half of the nation's telecommunications expertise and resources.

The MFJ broke up the Bell system and created an environment in which the divested Bell companies must compete to survive. The line-of-business restrictions now serve only anticompetitive purposes, protecting AT&T, other long distance, information services and manufacturing companies, and newspaper publishers from competition.

The public wants new services that the divested companies are prohibited from providing, and customers deserve the widest possible choice of providers. Further, if the divested companies could provide a full range of telecommunications services, local telephone customers would benefit from more extensive use of the networks. Under-utilized network facilities result in higher prices for consumers, particularly rural consumers.

Telecommunications is a complicated industry, but public policy requirements are very simple. Competitors of the divested Bell companies must have fair and equal connection to local exchange telephone networks; and they do. Local telephone service must be universally available at reasonable prices; and it is.

AT&T's denial of fair and equal connection to the local telephone networks was the key issue that led to the breakup of the Bell system. AT&T took this action in the belief that Congress wanted a nationwide telecommunications monopoly subject to pervasive regulation. As it turned out, this belief was not consistent with the concensus of public opinion in this country, or with the fundamental direction of telecommunications technology which continues to drive telecommunications towards competition.

AT&T's behavior earned it the distrust of its competitors and its regulators. This distrust, which now unfairly haunts U.S. West and the other divested companies, is the basis for the arguments you are hearing against our economic freedom. Ironically, even AT&T is making these arguments.

U.S. West is committed to competition in telecommunications markets. We have demonstrated this commitment in actions such as pioneering the equal access balloting process which was later adopted by the FCC as the industry standard. We do not deny connections to local telephone networks to any customer.

U.S. West is committed to providing all customers with access to essential components of the local telephone networks on the same terms and conditions, including price. Concerns expressed by competitors who oppose our economic freedom are motivated primarily by economic self-interest, not public interest.

U.S. West is equally committed to the second public policy requirement: Universally available local telephone service at reasonable rates. Our success as a business lies in keeping a full number of customers connected to our network.

U.S. West has carefully separated its regulated and its unregulated activities so that no cross-subsidy will occur. We have been audited since divestiture by the FCC, the Department of Justice, the National Association of Regulatory Utility Commissioners, and by individual state public utility commissions. None of these audits have substantiated any allegations of cross-subsidization between regulated and unregulated activities.

In addition, we are working with state regulators and legislators to implement price predictability programs to ensure that local service remains reasonable.

In conclusion, I urge that the Committee to proceed with S. 2565. If this Committee believes that guidance to the FCC is appropriate, it should direct the Commission to ensure that those who urge continuation of the line-of-business restrictions bear the burden of proof.

[The following information was subsequently received for the record:]

QUESTIONS OF THE COMMITTEE AND THE ANSWERS

Question. The antitrust case against the Bell System can be regarded as a result of regulatory failure. The FCC was unable to prevent the Bell System from engaging in anticompetitive behavior. Would the FCC be able to prevent anticompetitive behavior if the line-of-business restrictions were lifted?

Answer. While some may choose to regard the antitrust case against the Bell System as a result of regulatory failure, that view is not correct. A revolution in the application of new technology created the conditions for a competitive telecommunications industry in the years leading up to the antitrust case and the divestiture agreement. The most profound assumptions regarding the public interest in telecommunications industry structure were being questioned. The fundamental issue, debated in Congress and elsewhere, was whether competition or monopoly in telecommunications would best serve the public interest. Consideration of this question led to considerable uncertainty in policy formulation and implementation.

Whether or not the FCC moved rapidly enough toward competition in the pre-divestiture years can always be questioned. But is is unlikely that an alternative regulatory construct would have responded—or could in the future respond—more effectively to a rapidly changing environment. Detailed direction to the FCC concerning safeguards would hamstring the ability of the industry and its regulators to respond to technological and marketplace changes. These changes will certainly occur but their precise nature cannot be foreseen.

In the years of developing telecommunications competition prior to the divestiture, AT&T argued that an integrated, monopoly telephone industry was in the public interest and followed a deliberate policy of denying all non-Bell connections (of long distance suppliers or of telephone equipment) to its local telephone company networks. These were the anticompetitive actions that led to the divestiture agreement. (Predatory pricing, which is the only "cross subsidization" action that is an antitrust offense, was not germane to the divestiture settlement.) The FCC opposed AT&T's non-interconnection policy in several important respects. The Commission ordered AT&T to allow connection of non-Bell telephones to its operating company networks in the 1968 "Carterphone" decision and thereafter established technical standards (the Part 68 Registration Program) under which any manufacturer's equipment may be connected to the local telephone networks. In 1971 the FCC allowed specialized carriers into long distance markets, thereby setting in motion the process that resulted in the 1976 "Execunet" court decision that opened up all long distance markets to competition.

The public policy debate is now clearly resolved in favor of telecommunications competition. Equal access of long distance companies to the local telephone networks has been implemented as required in the divestiture agreement. In its Third Computer Inquiry, the FCC is well on the way to establishing equal access requirements for information services. And, the FCC is establishing (in its Docket 86-111) accounting and cost allocation procedures to safeguard basic telephone consumers against unreasonable charges. These safeguards are sufficient to prevent anticompetitive behavior (i.e., denial of interconnection to all providers on equal terms and conditions) if the line of business restrictions are lifted.

Question. Have the Bell Companies satisfied the equal access requirements of the AT&T divestiture decree?

Answer. The long distance carriers are using the political process to further their business interests when they raise the issue of compliance with the equal access requirements of the AT&T divestiture decree. The fact is that U.S. West is in compliance with equal access as defined in the divestiture decree (Modification of Final Judgment, Appendix B). U.S. West is not familiar with the details of the equal access plans of all the divested Bell companies. It is our understanding that these companies are in compliance, however.

U.S. West is dedicated to the provision of equal access. The long distance carriers are generally the largest customers of the local telephone companies owned by U.S. West and it is in U.S. West's business interest that all of these companies originate and deliver their long distance traffic over our local telephone networks. We have therefore developed working relationships with the competing long distance carriers that are far different from the pre-divestiture relationships such carriers had with the Bell system. The U.S. West companies understand their facilities are essential to provision of long distance services (and also information services) on a ubiquitous basis and are committed to making those facilities available on equal and fair terms to all providers.

Question. Some have argued that the Bell Companies are in a rush to diversify and that they are more interested in becoming conglomerates than in providing good, low cost local telephone service. Would you care to comment on that?

Answer. The U.S. West companies are characterized by the same drive to provide good, affordable local telephone service that was the hallmark of the pre-divestiture Bell telephone operating companies. Far from diverting resources from local telephone services, U.S. West is investing in its local telephone facilities at a rate of some $2 billion per year. This investment in new plant and equipment, in combination with strong management of expenses, has enabled the U.S. West telephone companies to provide basic residential telephone service at rates that continue to be a bargain compared to other consumer purchases. For example, the rate for basic residential service in the Denver metropolitan area is $9.22 per month. Denver customers paid $7.50 per month for local telephone service in 1900.

The importance of local telephone service to the U.S. West companies is apparent in responses to customer surveys that we use to guide our efforts to improve local telephone service. Survey results on satisfaction levels of residential customers are at, and frequently surpass, pre-divestiture levels. The dedication of the U.S. West companies, and of the other divested Bell companies, to local telephone service is also apparent in continued high rates of telephone subscribership. In the relatively rural states in which the U.S. West companies provide service, March 1986 Census data indicate that about 93.5 percent of households have a telephone and 95 percent of households have a telephone available (i.e., in the building in which they live). The U.S. West companies continue to explore opportunities, such as application of radio technologies to provide service to rural households, to raise the telephone subscribership level even higher. Local telephone service is the heart of our business, and we will continue to invest in it and to improve it.

Question. Is there a need to act quickly to lift the line-of-business restrictions?

Answer. Speedy action to remove the line of business restrictions is in the public interest. The current situation is unsustainable in the long run because it is not consistent with competitive principles or with technological trends that are increasing competitive opportunities in the local telephone exchange. Nevertheless, investments are being made every day under the assumption that the current situation is the long run status quo. The longer the line of business restrictions are in place, the larger the number of investors whose private financial interests will lie with maintaining the status quo, irrespective of the losses in efficiency and productivity of the telecommunications industry and U.S. economy that result. Delay will do nothing but intensify the pain of the eventual adjustment to competitive reality.

Consumers of telecommunications services are harmed by delay in removing the line of business restrictions. In the area of information services in particular, customers are now being denied services, such as call store-and-forward service, that could be provided over the local telephone networks but will not be provided to the general public by specialized providers, who target high-density, high-profit market segments. Provision of such services by the divested Bell companies would have the further public interest benefit of increasing usage of the local telephone networks, thereby spreading the cost of the networks and reducing the per unit cost of network usage for all users.

The telephone equipment manufacturing restriction is also slowing the delivery of lower priced services and new services to consumers. The manufacturing restriction leaves room for uncertainty about what constitutes manufacturing and what constitutes design and development. This uncertainty is readily exploited by manufacturers, particularly AT&T, who fear competition from the divested Bell companies and argue for an overly broad interpretation of what constitutes manufacturing. The effect of the manufacturing restriction is that telephone equipment markets are left open to foreign manufacturers while the Bell companies have no incentive to engage in research and development that would enhance the competitiveness of the domestic telecommunications industry and, therefore, the competitiveness of U.S. industry in general. U.S. competitiveness in international markets is not well served by thus restricting half the resources and expertise of the domestic telecommunications industry.

In interLATA long distance, the line of business restriction imposed on the Bell companies removes a competitive threat from AT&T and the one or two nationwide long distance providers that will most likely survive to compete with AT&T. The divestiture agreement allows AT&T to compete with the divested Bell companies in those long distance (i.e., intraLATA) services that the divested Bell companies are allowed to provide, however. By establishing this one-sided and unfair "competitive" situation, the consent decree can do nothing but hurt the divested companies' local telephone subscribers.

The consent decree draws an artificial distinction between types of long distance services (i.e., intraLATA vs. interLATA) that simply makes no sense. This distinction between "short" long distance and "long" long distance is essentially meaningless to consumers. With equal access to local networks assured by the equal access conversion process and by the FCC's Third Computer Inquiry, the divestiture agreement limits, rather than enhances, long distance services competition and the benefits that competition brings to consumers.

Question. What has changed since the divestiture that prevents the BOCs who control local monopoly facilities from discriminating against other long distance carriers?

Answer. Important changes have occurred in business strategy, technology and regulation.

U.S. West and, we believe, the other divested companies have no interest in engaging the costly and tiresome process of antitrust litigation. U.S. West and the other companies have met the equal access requirements of the Modification of Final Judgment. U.S. West is committed to making access to essential components of its local networks available on equal and fair terms to all those long distance and information services providers who want to use those facilities. U.S. West's business interests lie with maximum use of its local exchange networks. This basic interest is reflected in our philosophy, which is to accept and to work for competition in all our business endeavors.

Technological change and the competition that necessarily results is driving all sectors of the telecommunications industry to competition. Major portions of local telephone company revenues are already subject to potential competition because these revenues—for access services, intraLATA long distance services, and in many cases local exchange service—are concentrated among very few customers. Technology, such as fiber optic and digital radio transmission systems, and PBXs that perform the same functions as telephone central offices, is already available to compete for these customers' business; and the technology continues to develop. If local telephone services were priced to cover their costs, these competitive alternatives would be more apparent than they now are under the vestiges of regulated pricing structures and their mandated subsidies from long distance to local telephone services.

Regulatory developments, particularly the FCC's initiatives in its Third Computer Inquiry, are consistent with this view of eventual competition throughout the telecommunications industry. With the equal access requirements of the Modification of Final Judgment in place, the potential for discrimination among long distance providers is essentially removed. The FCC's initiatives to define and implement comparably efficient interconnection and open network architecture will assure that nondiscriminatory treatment of providers extends to enhanced services as well as to traditional long distance services. In addition to assuring equal opportunities for physical connection to local telephone networks, these concepts provide considerable protection against discriminatory pricing. These safeguards will be backed up by the cost allocation procedures that the FCC is designing in its Docket 86-111.

Question. What role should state regulators have regarding intrastate long distance? Should they get specific powers under any legislation? The FCC cannot regulate purely intrastate long distance today. Would or should legislation give them the power to do so?

Answer. Federal-state jurisdiction is an issue as old as the Constitution. U.S. West believes that the FCC and state regulators are in actual practice working effectively through the various Federal-State Joint Boards that have been established to address particular policy issues.

U.S. West believes that the public interest is served when regulatory structures reflect marketplace realities. Therefore, federal-state jurisdictional issues are a concern if they restrict the industry's ability to make adjustments, particularly in pricing structures, that are essential in the face of the technological change that is driving the telecommunications industry to competition. As long as federal and state regulators work together to facilitate the necessary adjustments in telecommunications pricing structures and other adjustment to competitive realities, the jurisdictional issues are not of major concern to us. Should those adjustments be frustrated, however, U.S. West believes that national interests in an efficient, productive telecommunications industry must prevail. In such circumstances, legislation might be appropriate.

The CHAIRMAN. Let me direct this question at Mr. Skibo because it takes up so much time if everybody is saying the same thing, but if Mr. Vasilakos or Mr. McGowan disagree with Mr. Skibo please jump in.

Mr. Skibo, I take it that the thrust of your concern is that if the line-of-business restrictions are lifted against the Bell Operating Companies that means that they will be able to go into the long distance business, that your concern is less with the other restrictions such as manufacturing or information services than their entry into long distance, and that you believe that if the Bell Operating Companies are allowed to go into the long distance business that will be anticompetitive? Is that the nub of your thinking?

Mr. SKIBO. That is our primary concern, that inasmuch as they still have control of the local bottleneck, we think that would put them in a position to have an unfair advantage over competition if they were allowed to get into the long distance business. That is a key concern of ours.

We have some less concern about manufacturing, obviously.

The CHAIRMAN. But is the essence of your concern really about allowing the local telephone company to go into the business of long distance?

Mr. SKIBO. Well, it puts you back in the same position under which the divestiture occurred in the very beginning, control of the bottleneck and having a subsidiary or another arm of the company in the long distance business. It is like putting seven AT&Ts back in business again. That is very much of a concern of ours.

The CHAIRMAN. What is wrong with the argument that if that becomes anticompetitive there can always be another antitrust suit?

Mr. SKIBO. Well, that is obviously a solution. I think there would probably be three companies here that may not exist at that point in time. Antitrust solutions take a long time to resolve, perhaps ten years or so, in getting that. So you could have a lot of companies go out of business.

The CHAIRMAN. I want to get to Mr. MacAllister in a minute, but just very briefly, do the other two, Mr. Vasilakos and Mr. McGowan, share this concern? And do you believe that the future of your companies are threatened should the Bell Operating Companies be allowed to go into the long distance business?

Mr. MCGOWAN. I think the issue is much more than what we have just heard. I think the issue here, very importantly, is what are we doing to the antitrust laws of the United States.

The CHAIRMAN. Well, I understand, but if you would just address yourself to the business concerns rather than to the legal concerns.

Mr. MCGOWAN. Unfortunately, I spent 12 years in the business concerns of antitrust violation, and that is a part of my business. We were accused for many years of a law firm with a microwave antenna on the roof, and most of that was spent in the antitrust courts.

The CHAIRMAN. Mr. Vasilakos?

Mr. VASILAKOS. Mr. Chairman, the answer is yes, I am very concerned that the BOCs be allowed back in the long distance business for reasons that Charlie Skibo indicated. That is, you are in effect recreating the situation that it took ten years in the antitrust trials to break apart. You are establishing seven, in my view, mini-AT&Ts and it has been shown historically that you can set up all sorts of rules and regulations, but they have never been effectively administered by the FCC in preventing the abuses that come when you mix monopoly and competition and you have your competitors dealing with the firm——

The CHAIRMAN. Could you just in a nutshell very briefly explain to a layman why that is noncompetitive?

Mr. VASILAKOS. Why it is not competitive?

The CHAIRMAN. Why it would be noncompetitive to have a local company go into long distance.

Mr. VASILAKOS. Because there is a basic conflict of interest. That is, they would be, the BOCs would be competing with ALC Communications in the long distance business. On the other side of the coin, I must go to them to get the essential connections necessary to serve my customers, and those are exactly the connections that they control in terms of when they deliver them, how they price them, how rapidly they fix them, how they set up their operations to provide their long distance service.

I mean, I think the analogy is that if you went to American Airlines and said, look, we are going to allow you to continue to compete in the airline industry. The only thing we are going to change is that you have to buy or rent all your terminal facilities from United Airlines through whatever procedures and systems they set up.

That is the kind of situation. I think the people who run American Airlines would tell you, that is not going to work.

The CHAIRMAN. Mr. MacAllister, why is that not a point well taken?

Mr. MACALLISTER. Well, first of all, we have some examples in America of companies like United Telephone and General Telephone that are operating both large local operations and long distance, and apparently doing it successfully.

We have learned a lot in the process of going through the antitrust process, and our fundamental premise at U.S. West is that we want to maximize the use of our access facilities by selling under equal terms and conditions to not only our own companies but to our customers. It makes good business sense for us to maximize the use of the network, and we are doing everything we can to do that.

I think that the economic motive for avoiding antitrust issues and for marketing our services to interstate carriers is a very strong one, and I think it would preclude us from going through the tiresome and costly process of antitrust again.

The CHAIRMAN. Senator Gorton?

Senator GORTON. Mr. Vasilakos, I will just ask one follow-up question to Senator Danforth. Would you respond to those two points that have just been made by Mr. MacAllister, that there are a bunch of companies that are already doing it without any adverse effect on competition, and the economic motive for avoiding antitrust.

Mr. VASILAKOS. Well, with regard to the first, I do not think you have a comparable situation. GTE and United do not have the concentrated operating telephone company monopolies that exist within the Bell Operating Companies. That is, you do not find that either GTE or United, which I think were the two mentioned, have seven or eight contiguous states where they basically provide 98 percent of the lines.

Secondly, the fact of the matter is that neither GTE nor United were found guilty or were accused of violating the antitrust laws. So you are trying to compare two companies that were not in the same boat as the Bell Operating Companies. And the BOCs do have concentrated monopoly power in geographic areas that is not comparable to any of the operating entities of GTE and United.

Senator GORTON. Well, is not Mr. MacAllister right, that you have to learn from the terrible experiences and changes resulting from the antitrust lawsuit that are unlikely to run the same kind of risks, again?

Mr. VASILAKOS. I think that the incentives and the motivations for whether you call it cross-subsidization or cooperation between the competitive arm and the monopoly arm are so strong that it will happen.

And as a businessman, I can tell you that if you made me chief executive officer and gave me one competitive business and one monopoly business, it would be irresistible not to strategically optimize the management of those operations to my best interest. It is just a fundamental, in my view, conflict-of-interest situation that I do not know how you regulate, and I think based on the ten-year antitrust trial and the history, or at least the 13 years I have been in the business, the simple way to do it is to separate, in other words not allow that situation to exist.

With regards to the other, well, I think I have commented on the regulation side.

Senator GORTON. That is all.

The CHAIRMAN. Senator Long?

Senator LONG. Let me just ask you about this, Mr. McGowan. Those relay towers are not very beautiful, especially on a mountain top. We have got a beautiful city. Those relay towers do not make it look any better. That red light is all right; it will help you get around at night.

But as I understand it, MCI and I guess Sprint—we can ask them—they are building a duplicate system. I know in the area where I am, they wanted to use some of my property for a relay station. They have already got a big relay station over there in clear sight. I can look out and see a big relay station, but I do not think it is being overused. And, of course, they want to build another one, and I guess Sprint would do the same thing.

Are we going to have to have three times as many relay stations around the country? Or is it possible to get the companies to join together and share one station? I do not think they are beautiful on that location. I would be willing to give that one back willingly just for the benefit of not lousing up the beauty of the landscape.

What can you suggest to me about that?

Mr. McGOWAN. Senator, you have to understand I have a color photo of perhaps that tower in my bedroom. I think they are gorgeous.

Senator LONG. Not many people do.

I talked to my neighbor about the idea of putting your tower over there on my property and bless her heart, she said, "I am moving. I will leave."

Mr. McGowan. Senator, there are a number of locations that we do co-locate in that we find it much more economical for power, access, shortage of land, path frequency.

But a more important thing that is happening which I think you will find apparently to your pleasure, the more important thing that is happening is that in many areas of the country we have found that there is sufficient volume in communication and technology has been developed to allow us to put in fiber optics. Fiber optics which are basically laid underground will be in the not-too-distant future the major way of communicating long distance in the United States.

In some areas of the country, there is still not enough volume to justify it, but in most areas and certainly in your area there would be sufficient volume to justify it. So we anticipate certainly beginning in the 1980s and certainly before the end of the 1990s that fiber is going to be the dominant way of communicating long distance.

Overseas there will still be use for satellites and for specialized applications in the United States, but in the case of the satellite communication with very small aperture earth stations they literally would be sitting on a rooftop, probably no more than 30-inch dishes, and would not even be noticeable by people. So I do not think you will find the problems with microwave towers for very long in developed areas.

Senator Long. Well, I am not talking about something down the road. I am talking about now. You are still out there building towers where there is already a tower that would relay all the signals.

Mr. McGowan. Well, microwave towers have been around since the second world war. Probably the largest microwave system, perhaps obviously, is still AT&T system. Our system is——

Senator Long. Well, I am just talking about why cannot you share their towers with them and pay them your share of the cost rather than build another tower right alongside them or five miles away?

Mr. McGowan. It is only recently that AT&T and MCI have even talked to each other, except through lawyers.

But we have been working much more cooperatively on transmission in the last couple of years, and I will certainly investigate that particular tower this afternoon.

Senator Long. Incidentally, I am satisfied that that would be great good news to everybody in the area that there are not going to be any more towers out there. But just from the environmental aspect—and I am not a Ralph Nader man; he campaigns against me, and I am not excited about him—but in my own way I am very much an environmentalist. I do not like to louse up the landscape with a lot of stuff that is not beautiful and is not necessary. And I do not think your tower is pretty. I sit there and look at one day in and day out, but thank God that one is five miles away. But by the time you start putting them right next door to me, it gets a little bit different.

Mr. McGowan. Are you sure? It probably was Sprint's, I think.

Senator Long. No, I know it was MCI. I got a letter from them.

If you can provide me anything more to make me feel comfortable about it, I would like to have it. Thank you.

Mr. McGOWAN. Thank you. We will.

The CHAIRMAN. Thank you very much.

The next panel is John McDonnell, Electronic Industries Association; Barbara Easterling, Communications Workers of America; Zane Barnes, Southwestern Bell.

Mr. McDonnell, would you go first, please.

STATEMENTS OF JOHN J. McDONNELL, JR., GROUP VICE PRESIDENT, INFORMATION AND TELECOMMUNICATIONS TECHNOLOGIES GROUP, ELECTRONIC INDUSTRIES ASSOCIATION; BARBARA EASTERLING, EXECUTIVE VICE PRESIDENT, COMMUNICATIONS WORKERS OF AMERICA; AND ZANE BARNES, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, SOUTHWESTERN BELL CORP.

Mr. McDONNELL. Good morning, Mr. Chairman. My name is Jack McDonnell. I am the group vice president of the Information and Telecommunications Technologies Group of the Electronic Industries Association.

Our group represents over 100 U.S.-based manufacturers of telecommunications equipment who account for roughly 85 percent of U.S. production of telecommunications equipment. Such equipment is both used in and connected to the telecommunications network. I appreciate this opportunity to appear before you today to present our views on S. 2565.

You have heard many views this morning on the propriety of transferring authority from the judiciary to an independent agency. To the telecom manufacturers of this country, the real issue is not which governmental authority administers the AT&T Consent Decree, but rather whether or not the BOCs will be permitted to manufacture telecom equipment while they still have a monopoly on bottleneck facilities.

Let me state at the beginning of my testimony clearly and categorically that it is extremely bad public policy when a monopoly provider of a utility service is allowed to manufacture the equipment used in the provision of that service. It is bad for competition; it is bad for the consumer; it is bad for investment; it is bad for labor; and it is bad for international trade.

We do not allow our electric utilities to manufacture generators, transmission facilities, or light bulbs. In the case of telecommunications equipment, there is no country in the word, with the single exception of Canada, where the monopoly service provider also controls the primary manufacturer of telecommunications equipment. And in the Canadian case, the situation there is very much an offshoot of the old Bell System in the United States.

How quickly we forget. I would remind this Committee that the AT&T antitrust case was originally begun by the Justice Department precisely because AT&T was a monopoly provider of communications service and was also a manufacturer of telecommunications equipment.

A return to such an anticompetitive environment is the last thing which anyone in the telecom equipment manufacturing industry desires. S. 2565 is a clear step in that direction and a living tribute to the effectiveness of the BOC public relations effort.

Since the January 1984 divestiture from AT&T, the Bell Operating Companies have demonstrated a continuing anxious desire to enter the three lines of business from which the Modified Final Judgment specifically excluded them: information services, long-distance services, and equipment manufacturing including Customer Premises Equipment.

Prior to the introduction of the Dole bill, Judge Greene and the Justice Department who administer these restrictions gave no indication that they were of a mind to lift the restrictions. Reacting to this strong position, the BOCs have turned their attention away from the court system to the Congress where thanks to an effective and costly campaign they have succeeded in having a number of proposals introduced in the House of Representatives which would lift the MFJ restrictions.

In February of this year in Congressional hearings on those proposals the FCC Chairman, Mark Fowler, declared in response to direct questions that he was in favor of legislation to lift the MFJ restrictions from the BOCs. Then just over three months later, the Senate Majority Leader introduced legislation which would transfer authority over the MFJ from the restrictive Judge Greene to the permissive Fowler Commission.

If S. 2565 passes, the BOCs will have effectively bypassed the judicial system and placed the issue before a regulatory commission whose Chairman has clearly prejudged the issue.

The argument then no longer turns on whether or not this is a simple transfer of jurisdiction over the MFJ. It is really an argument over why the restrictions were imposed in the first place and whether or not they should now be lifted. As a spokesman for the telecom equipment industry, I am convinced that the restriction on manufacturing should not be lifted at this time.

In your hearing notice you raised several questions regarding safeguards and conditions necessary to be put in place prior to removing these restrictions. In addition, the question of defining manufacturing was also raised. I would suggest that a precise definition of manufacturing, given the drastic change in the design of modern telecom equipment compared with 20 years ago, is a necessary exercise.

However I can state categorically that once that definition is in place, there are no conditions or safeguards which could make it good public policy to permit a monopoly provider of service to manufacture equipment which would be used in the provision of that service or connected to that service. In this regard, I would like to refer you to the Findings' Section of the Public Utility Act of 1935. Those findings are as definitely true today as they were in 1935.

The main reason that the restriction should not be lifted is because the BOCs can exercise a profoundly anticompetitive effect on the market. The BOCs are the monopoly providers of local exchange service within their franchised areas. Being in such a powerful position, they have a variety of ways in which they can disadvantage manufacturers of competing products. For instance, looking only at customer premises equipment issues, the BOCs could employ advance knowledge with respect to changes in the local exchange network in order to achieve a "head start" over manufacturers of products which would compete with their "house brand". The BOCs might also configure network interface specifications in a way which would work to the advantage of their own product line. Finally, the BOCs could discriminate in favor of particular products with respect to types of interconnection, testing, maintenance, and similar matters.

The BOCs have the ability to cross-subsidize their development of specific products by configuring their activities in ways which would permit costs associated with equipment development to be assigned to rate-based, regulated activities. Discriminatory transfers of network-related technical information also constitute a form of cross-subsidization. Particularly worrying to observers in the telecommunications equipment manufacturing industry, is the attempt over the past two years to steadily erode the Computer II structural separation requirements and other regulatory constraints which might check the BOCs' potential for anti-competitive, cross-subsidization behavior.

Hand-in-hand with the ability and opportunity of the BOCs to discriminate and cross-subsidize is the incentive to do so. A rate-based, regulated firm wholly integrated into manufacturing will have made an investment in a particular product line which is indistinguishable from the investment made by manufacturers of competing products. Having made this investment, the BOCs' clear incentive is to maximize its return by favoring its "house brand" over other manufacturers' products. Furthermore, the BOCs have the ability to cross-subsidize their development of specific products by configuring their activities in ways which would permit costs associated with equipment development to be assigned to rate-based, regulated activities. This is a form of capitalization which is not available to competitors of the BOCs; it is an extremely anti-competitive type of behavior.

It is important to remember that the antitrust litigation in the District Court amassed a detailed record of anticompetitive effects. The MFJ was intended to end the anticompetitive problem once and for all by requiring the divestiture of the BOCs from AT&T and its affiliated manufacturer and by prohibiting reintegration into the manufacturing business.

The MFJ was the culmination of a 12-year effort by the U.S. to dismantle the finest communications system in the world because it was dominated by one vertically integrated company. It is almost incredible that the country is now being asked to contemplate as a desirable social and economic objective the prospect of seven new vertically integrated telecommunications companies.

The Congress should not disregard the record which led to the MFJ. If the Congress is determined to consider legislation permitting the BOCs to manufacture equipment—and quite frankly that is exactly how I regard S. 2565—it should focus attention not only on the record compiled in the antitrust litigation, but also on the evidence compiled in state public utility commission proceedings. That evidence indicates that local telephone ratepayers do not benefit and are indeed penalized when the telephone company buys equipment from an affiliated manufacturer.

Under the strictures of the MFJ, the BOCs have a greater incentive to buy the best equipment available at the best possible price through competitive procurement. If however the BOCs enter the manufacturing business, they will resume the practice of buying their own affiliates' equipment at inflated prices and pass the costs on to consumers in the form of higher telephone rates.

The BOCs most likely will become vertically integrated companies like the old AT&T, and they will—like the old AT&T—have the ability, the opportunity, and the incentive to engage in such cross-subsidization. They will maximize their return by favoring their house brand over other manufacturers' equipment. They will not obtain the best quality equipment at the lowest price. In the end, it will be the rate-paying consumer who will have to pay higher phone bills to finance this unnecessary expansion by the BOCs. For there is nothing which the BOCs buy today which cannot be supplied by one of the more than 500 domestic manufacturers of telecommunications equipment.

The BOCs have suggested that permitting them to engage in the manufacture of telecommunications equipment will help eliminate the precipitous slide in the U.S. telecommunications balance of trade. It is important to remember that, historically, the monopoly telephone industry did not export. On the other hand, independent equipment manufacturers frequently export a significant percentage of their production. Legislation allowing the BOCs into manufacturing may cripple the ability of the most aggressive U.S. exporters to compete in world markets. To make matters worse, such legislation would undercut U.S. efforts to persuade foreign administrations to open their domestic markets to manufacturers other than those indigenous manufacturers which they have historically favored. In any event, since the BOCs tend to diversify through acquisitions rather than de novo entry, no new productive capacity would be created and the U.S. trade balance would not be improved.

Finally, turning to a brief consideration of the judicial process, we in industry are concerned that the legislative efforts being made by the BOCs to circumvent the MFJ are an unprecedented usurpation of judicial authority and that, if successful, may encourage further assaults on the independence of the judiciary. There is very much an issue of due process involved; in the industry coalition of people opposed to the Dole bill, one hears talk of "court stripping". The way to refine the MFJ is to wait for the report on the MFJ restrictions to be completed—a report which is mandated in the MFJ itself and which is currently being written by a Department of Justice consultant. When that report is in—and it is due by January 1st, 1987, a mere three and one-half months away—it will be time enough to consider lifting any of the restrictions. While these concerns do not fall directly within the purview of this committee, they are relevant, nevertheless, in our belief that current BOC endeavours may destroy the competitive, post-divestiture environment for telecommunications equipment.

It is clearly a complex issue, an issue which should not be prejudged by an arbitrary transfer of authority. In the meantime, let no one be fooled by the argument that the FCC can become the home for all telecommunications policy. For one must note that the

Department of Commerce and the Department of State are not likely to relinquish their territorial claims, even if Judge Greene and the Justice Department are removed from the picture. The real issue is whether the BOC restrictions should be lifted.

I ask this committee to bear in mind that manufacturing, like long-distance and information services, is, at present, a competitive market—but it is a market highly vulnerable to unfair competition by the BOCs. The Dole Bill, if passed, would effectively provide them with carte blanche to expand into this competitive market. And, as I have stated, the evidence already exists in state public utility commission proceedings to show what happens when the local monopoly telephone company enters competitive enterprises: the local telephone ratepayers do not benefit and are indeed penalized. Since divestiture, the BOCs have already increased rates by $5 billion while diverting capital to countless competitive acquisitions and start-up ventures. In order to enter and subsidize competitive manufacturing, long distance, and information service enterprises, even higher local rate increases will be required.

In summary then, the Dole bill if enacted could result in an increase in local telephone rates and could complicate the task of State and Federal regulators. It would destroy the competitive environment for telecom equipment, long distance, and information services, and would combine the worst features of both the pre- and post-divestiture eras. Thank you.

[The following information was subsequently received for the record:]

QUESTIONS OF THE COMMITTEE AND THE ANSWERS

Question. Some have argued that you simply want to keep the Bell Companies from competing with you—that you just want to shut out the competition in manufacturing. What is your response to that argument?

Answer. The whole of my testimony on September 16, 1986 addressed the issue raised in this question. In brief, let me state that the argument mentioned is a gross simplification and total distortion of our position. EIA/ITG is not opposed to competition in manufacturing; we welcome competition and do everything to encourage it. Our position is that the Bell Operating Companies are a unique type of potential competitor because they have monopoly control of telecommunications services. Because of this monopoly control, the BOCs are very very different from all other manufacturers of telecommunications equipment in the U.S.A. today. Allowing the BOCs into manufacturing would be a major change in telecommunications policy; it will seriously harm the current competitive environment and will lead to a repetition of the abusive practices which led to the AT&T divestiture in the first place.

Question. Don't you think that allowing the Bell Companies, with their vast resources, to manufacture telecommunications equipment would help the United States to compete internationally?

Answer. Helping the U.S. to compete internationally may be accomplished in many ways. One major way is to open foreign telecommunications markets to U.S. products. Many of the current U.S. manufacturers of telecommunications equipment also have vast resources and have had little enough success in penetrating closed foreign markets. Opening foreign markets is an urgent continuing item at a government-to-government level. The advent of seven new U.S. manufacturers, no matter how large, will not of itself automatically change the policies of foreign governments towards U.S. telecommunications equipment sales.

Increasing U.S. competitiveness, in the final analysis, is a complex issue. Government subsidies to small- and medium-size U.S. firms willing to open plants overseas; American commitment to long-term investments in plants with efficient production methods; an overall U.S. industrial-telecommunications policy are among other suggestions made by industry analysts (see "USA Seeks to Close Telecom Market to Japan", Telecommunications, September 1986, 136–144).

Question. What will prevent the RBOCs from entering joint ventures with foreign companies or importing products which would be in direct competition with domestic manufacturers?

Answer. This is precisely the sort of public policy question in which Congress is rightly interested. Some months ago, one of the Regional Bell Operating Companies, Ameritech, actually sought a waiver from the MFJ so that they could manufacture telecom equipment overseas. EIA/ITG opposed that request, a request which Judge Greene granted with the specific proviso that Ameritech could sell such products solely in overseas markets i.e. he ruled against "back-door" entry into the U.S. domestic market.

"Back-door" entry into manufacturing, as envisaged in this question, contravenes the letter and the spirit of the Modified Final Judgement prohibition on manufacturing. Effective and forceful administration of the MFJ will prevent its occurence.

Question. What provisions do we need to ensure that more American jobs will not be lost in high technology areas?

Answer. I can speak only for that high technology area known as telecommunications equipment manufacturing. In addition to the suggestions mentioned in my answer to question 2 above, I believe that the enactment of legislation designed to open foreign telecom markets—legislation such as S. 942 or H.R 3131—is the best provision currently available to ensure growth in the U.S. telecom equipment manufacturing workforce.

The CHAIRMAN. Thank you, sir.

Ms. Easterling.

Ms. EASTERLING. Good morning. I am Barbara Easterling, executive vice president of the Communications Workers of America. Our organization represents more than 600,000 private and public sector workers who live in all 50 States, in each of the 435 Congressional districts, and in more than 10,000 communities throughout the Nation.

My purpose in appearing before you today is to make the Members of this panel aware of our deep concern that the people who built the world's best telephone system may be tossed onto the economic scrap-heap if S. 2565 is adopted in its current form. That legislation, and indeed most of the debate on proposals to change the consent decrees, ignore the working people of the telephone industry whose dedication is indispensable in providing quality service to America and the world.

Under S. 2565, communications workers would become the "ghost in the machine," a forgotten but essential element in the future of the industry. CWA contends that employee protection should be a critical component of any legislation that could further restructure the industry in which our members play a vital role.

In essence, Congress should assert jurisdiction over national telecommunications policy and take steps to ensure that the Regional Bell Operating Companies, AT&T, and GTE focus on people as well as profits.

We would hope that the companies and policymakers would concentrate on the human deficit of unemployment as well as the corporate deficit in their vision of the future. While the telephone companies are busy romancing Wall Street with dreams of new economic horizons, we fear they may turn their backs on Maple Street where telephone workers live and on Main Street where they shop, unless the Legislative Branch intercedes.

CWA members have already endured one wrenching restructuring of the telephone industry in this decade, caused by the divestiture of the American Telephone and Telegraph Company. That unprecedented corporate reorganization resulted in thousands of loyal, efficient, telephone workers experiencing layoffs, downgrades, pay cuts, transfers, and refusals to rehire them within the industry in which they were trained. Indeed, a climate of confusion and shattered morale characterized the impact on employees during the last restructuring of the telecommunications industry and continues to exist even today.

Now your Committee and the public at large are being asked to give another blank check, this time to the Federal Communications Commission. The lessons of divestiture could not be clearer to us, but our members stand to be further disadvantaged. In the time since divestiture, we have seen a drop in employment in AT&T of some 33,000 jobs. In the telephone operating companies, we see an indicated drop of about 60,000 jobs; that is based on company numbers in the Form "M" reports that were filed with the FCC for the years 1983 to 1985.

Let me give you a few examples of what these enormous numbers mean on a human scale. One worker was declared surplus, moved 450 miles, and was declared surplus again and moved again 70 miles. For a time after the second move, the man lived in a fishing camp and commuted home on weekends.

Another working group's office was closed with the work transferred to a city 2,000 miles away. Only a few of the 360 employees were in a position to accept such a move.

Mr. Chairman, CWA firmly believes that Congress should play the chief role in authorizing any change in the business activities of the Regional Bell Operating Companies. This important responsibility should not be handed off without detailed guidance to the Federal Communications Commission, as would be the case if S. 2565 were enacted in its present form.

The FCC should not be given a blank check on such a significant matter. Occasionally even blank checks bounce. If S. 2565 is to become law, it requires amendments of the type you outlined at the time you announced these proceedings. Along this line, it is useful to be aware that the Federal Communications Commission is not equipped to deal with the employment aspects of any restructuring of the telephone industry.

The Commission does not include on its staff a single labor economist. No manpower specialist occupies space in the Common Carrier Bureau. In its order of June 18 in the Third Computer Inquiry, the FCC declined to act on CWA's request for supervision of the people concerns emerging from that major policy advance. As a demonstration of its lack of concern for the men and women employed in the industry, the FCC order brushed away our substantive petition by a mere footnote.

CWA has always supported efforts to permit development of the telecommunications industry. Today it is no different. We do not appear here to say that we will never support entry by the RBOCs, AT&T, GTE or others into new businesses. Still, some proposals cause more concern than others. Moreover, all proposals lack one essential ingredient: minimum employee protections.

Finally, given the lateness of these proceedings in the 99th Congress, we remain concerned that many key issues may not receive due consideration. However, these hearings certainly will be useful as a start for work in the 100th Congress.

Thank you.
[The statement follows:]

STATEMENT OF BARBARA J. EASTERLING, EXECUTIVE VICE PRESIDENT, COMMUNICATIONS WORKERS OF AMERICA

Ten years ago we and others began urging the Congress to set national telecommunications policy for the guidance of the Federal Communications Commission and the Federal court system; the rationale was that the common carrier statutes of 1934 were not proving effective in dealing with the realities of the new "competitive" era.

Your Committee is considering S. 2565, offered by Senator Dole. Let me express our organization's strong reservations on this approach, unless it is amended to give definite guidance to the FCC. As introduced, S. 2565 amounts to a "blank check."

While all of the Congressional activity did not lead to new legislation, we have experienced a major revision of telecommunications policy through divestiture. The effects on workers were painful and devastating. At divestiture, no employee protection measures were included in the agreement between the government and AT&T. The masterminds of the divestiture fiasco surely never thought of what the breakup would do to the people we represent or our international trade posture.

Now your Committee and the public at large are being asked to give another "blank check"—this time to the Federal Communications Commission. The lessons of divestiture could not be clearer to us—that our members stand to be further disadvantaged. At divestiture, total employment in the Bell Operating companies was 588,000, with 565,000 in the regulated basic service business. At the end of 1985, employees of the BOCs totaled 504,000. In the time since divestiture, we have seen a drop in employment in AT&T of some 33,000 jobs. In the telephone operating companies, we see an indicated drop of about 60,000 jobs, based on numbers in the Form "M" reports filed with the FCC, for the years 1983 to 1985.

Last February 20, CWA outlined the extensive hardships visited on individuals, families and working groups as a result of the divestiture. The list included some long-service employees, who were forced to move in some cases twice, then laid off. One worker was declared surplus, moved 450 miles, declared surplus again and moved another 70 miles. For a time after the second move, the man lived in a fishing camp and commuted home on weekends. Another example was in a supply house which closed, with 460 losing their jobs; about 125 were able to move to a new location, more than 100 miles away. Another 100 were able to take early retirement and supplemental pay benefits. The others received only termination pay. Another working group's office was closed, with the work transferred to a city 2,000 miles away. Only a few of the 360 employees were in a position to accept a move.

While S. 2565 is described as essentially a very simple bill, it has serious flaws in that the FCC is given no guidance as to how it will administer the AT&T and GTE consent decrees. We recognize that the Congress cannot exercise day-to-day supervision of telecommunications; but we suggest that these issues are so important and vital to the nation and its economy that the Congress must keep the finger on the pulse, to ensure that the FCC keeps to its job of exercising powers specifically delegated by the Congress. In fact, it has been the lack of clear and specific employee protection standards which has led to enormous difficulties. No matter what version of legislation ultimately is enacted, we believe the industry's workers deserve some minimum guarantees and protections. Indeed, we think that Congress, the courts or the FCC, if they do nothing else, should establish protections so that workers with 15, 20 or even more years of service do not have to worry about arbitrary or unfair treatment.

Issues relating to expansion of activities, entry into other lines of business and operations beyond an exchange carrier's franchised area involve more than antitrust issues. They go to broader matters encompassed in the term "public interest" and include, as indicated by Senators Dole and Danforth, questions of national security, trade balance, jobs and consumer interests. The FCC was created in 1934 to deal with issues where delicate balance is needed to be struck to determine which of a set of proposed actions would best serve the public interest. It is refreshing that the Congress is looking at the public interest, rather than merely unrestrained corporate activity, which appears to be the Commission's orientation.

We take encouragement from your proposed outline amendments to protect ratepayers and competitors and provide for safeguards. Since we do not have the actual language of the amendments, we cannot comment specifically. A worthwhile aspect is the inclusion of the several public interest determinations to be made by the Commission, including the effects on employment of American workers. Currently the

Commission is not equipped to deal with the employment aspects of any industry restructuring; it has neither labor economists nor manpower specialists. The Commission should be directed to develop this area of expertise. The Commission should be directed to develop this area of expertise. The Commission showed a lack of concern for the "people" concerns in its June 18 order in the Third Computer Inquiry, by brushing away our substantive filing with a mere footnote.

Under various proposals, the divested Bell Operating Companies would be allowed into new ventures including information services, manufacturing and inter-LATA toll service. Each of these needs to be addressed separately.

We understand some BOCs wish to engage in "manufacturing" in the United States. We have long been seeking a definition of the term "manufacture," in connection with our long involvement in national trade policy. Currently, a mere domestic assembly operation can be termed "manufacturing." Given the depression now existing in U.S. manufacturing, it would be useful to know if new plants will be added and where; it also would be useful to learn if the BOCs truly are experiencing shortages or other actual difficulties in securing the goods they need to serve their customers.

CWA has been a supporter of your bill, S. 942, and the companion House bill, to ensure a fair shake for U.S. telecommunications makers in foreign markets. We hope the 99th Congress will enact this legislation to start to make a dent in the scandalous trade deficits.

The provisions of inter-LATA toll service by other than local exchange carriers was a key feature of the AT&T divestiture agreement. Its theory was to separate the monopoly-source local exchange services from the competitive-source inter-exchange toll. We believe it is far too early in the post-divestiture era for any change in this matter.

The BOCs have said they wish to offer various kinds of information services, using existing facilities in most instances. The BOCS contend that their competitors are free to offer such services at will. The companies would and should use strict accounting procedures to protect competition and ensure that local exchange operations are fully compensated for use of facilities and associated services. CWA is not inclined to press for structural separations, since the union has seen many of its members laid off and otherwise disadvantaged in the last two years.

CWA has always supported efforts to permit development of the telecommunications industry. Today is no different. We do not appear here to say that we will never support entry by the RBOCs, AT&T, GTE or others into new businesses. Still, some proposals cause more concern than others. Moreover, all proposals lack one essential ingredient—minimum employee protections to avoid the debacle we've witnessed in recent years.

If the Congress enacts S. 2565 or similar legislation, it should include a provision to require that the Commission will specifically conduct appropriate public interest proceedings and decide on the basis of a full record. In this manner, the inevitable Court of Appeals process will consume a minimum of time and the policy judgements will be more appropriate.

In the event legislation moves forward, we would work with the Committee to provide some language to address the concerns of the men and women whose lives would be changed by government and corporate action. Past experience shows that clear, unequivocal and enforceable standards must be given the court, the FCC, the RBOCs, AT&T, General Telephone and indeed any major industry employer, in order to protect the interests of America's telecommunications workers.

As noted earlier in this statement, the Commission now lacks the staff resources to handle this important aspect of regulating the business. We suggest the Commission be directed to remedy that situation.

Finally, given the lateness of these proceedings in the 99th Congress, we remain concerned that many key issues may not receive due consideration. These hearings certainly will be useful as a start for work in the 100th Congress. By that time, the Department of Justice will have received the "Huber Report" to be forwarded to the District Court for the required three-year review. The Court in 1987 may be adjusting its oversight of the AT&T and GTE consent decrees to meet some of the aims of proponents of S. 2565 and H.R. 3800.

(The following information was subsequently received for the record:)

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. Do you think that Congress should condition the entry of the Bell Companies into manufacturing on a requirement that they manufacture domestically?

Answer. Yes. The Congress must set conditions which make it impossible for foreign-sourced goods to be labeled or considered "domestic." The rules must be sufficiently clear to the U.S. Customs Service so that goods made abroad by foreign subsidiaries of U.S. companies are either embargoed or entered at heavy tariffs. An agreement barring entry was made by Ameritech as one condition of granting the line of business waiver to engage in foreign manufacturing operations. The District Court requires Ameritech to ensure that none of the foreign-produced goods enters the United States market.

Question. Do you think that Congress should define "manufacturing" to distinguish it from assembly of already-made parts?

Answer. The Congress must provide a clear definition of the term "manufacturing" to ensure that far more than merely packaging and/or assembling are done in the United States. The legislative language would be phrased to ensure that domestic "manufacturing" operations are not merely plants at which foreign-produced components are assembled; the United States employment effect of such operations is essentially insignificant. In such operations, the "high-technology" aspects, in which industrial progress is made, do not accrue within the United States.

One way to engage in deception in using that term "manufacturing" is as follows:

Foreign components are sent to United States assembly plants in such a manner as to ascribe more than 50% "value-added" in this country. The calculation basis is the foreign-source price. The U.S. "value-added" begins with stateside payment of ocean freight, insurance, customs and other costs associated with delivering the components to the "manufacturing" plant. Up to this point, the U.S. jobs content is essentially zero, or very slightly above zero.

In the assembly plant, the so-called "manufacturer" then can include direct and allocated plant costs, packaging of finished goods, shipping of goods to jobbers and wholesalers, and various sales, merchandising and advertising costs and profit.

The process described above involves very minor use of U.S. labor and industrial plant capacity—none involving the seminal high-technology variety. The "high-tech" part is done overseas.

Since the BOCs themselves have raised this domestic manufacturing issue to its present high pitch, they surely should consent to a considerably less indefinite meaning of the term "manufacture" than can be at best inferred from existing law. For example, domestic manufacturing should mean a minimum of 70% of U.S.-made components. This would be a reasonable standard, giving proper recognition to the fact that some minerals are not indigenous to the United States. In calculating "value-added" for the purposes of this legislation, non-manufacturing costs should not be included. The legislative history can and certainly should provide the criteria for rules of origin of the telecommunications goods in question. The rules of origin would fall in several classes, including goods which are wholly produced in the United States (some definitions were developed by the Kyoto Convention under auspices of the Customs Cooperation Council to simplify goods-entry procedures). Also one can examine "substantial transformation" of materials within the United States, connoting the use of some foreign materials. In this latter category are the methods of determining when a "substantial transformation" has occurred: changes in tariff heading, percentage limitation of the product's foreign value, and "sufficient working or processing" to create a new and different article of commerce.

Question. What will prevent the RBOCs from entering joint ventures with foreign companies or importing products which would be in direct competition with domestic manufacturers?

Answer. One means of preventing joint ventures with foreign suppliers and other entities is to condition grant of the shift of jurisdiction sought in S. 2565 thereon. The same kinds of conditions should be attached to importation of parts, subassemblies, components, units and otherwise-designated goods. In this context, the "foreign supplier" label would not be attached to foreign companies which actually produce goods in the United States. The same banning conditions would apply fully to attempted importation of products of foreign-based operations of United States companies.

In the year since public notice of the issue of allowing RBOCs to manufacture equipment, no clarification has been forthcoming. In fact, two contradictory statements come forth:

a. H.R. 3800 expressly provides for manufacturing in the United States; the RBOCs have been actively pursuing this legislation in the House of Representatives at the same time as they are pressing for S. 2565 in the Senate. On the surface, the RBOCs appear to be in the context of domestic manufacturing.

b. In testimony September 16, an RBOC witness declined to commit on domestic sourcing of its equipment needs, noting that foreign-sourcing probably would be done.

In brief, to respond to this question, the legislation can flatly impose conditions on those seeking the legislation, the RBOCs. It was the RBOCs that have raised the issue, including the "domestic" benefits.

Question. What provisions do we need to insure that more American jobs will not be lost in high technology areas?

Answer. Enactment of S. 942 is a key part of the solution. Prohibition of investment tax credit can be another aspect, as was shown in the Houdaille machine tools case. The foreign tax credit should be repealed (as in the pending tax reform legislation). The United States should restrict investment in foreign manufacturing operations, given the current status of domestic industry, i.e., the near-depression in manufacturing, with only 78% of plant capacity currently in use. We are in process of buying another depression, unless the Congress acts to prevent it; "free trade" is a bankrupt policy, encouraging the exit of large segments of American business activity to low-wage havens.

The CHAIRMAN. Thank you.

Mr. Barnes.

Mr. BARNES. Mr. Chairman, thank you and the Committee for inviting me to testify before these proceedings. Let me say that for quite some time now Southwestern Bell has been calling attention to the policy crisis we see developing and the practical dislocations we are living with as a result of the terms of the AT&T Consent Decree.

Enacting S. 2565 we believe will help untangle the emerging regulatory gridlock which is stalling creativity and stifling innovation in this industry. There are two distinct and separable sets of issues that I wish to discuss today.

The first has to do with consolidating Federal regulatory authority over the telecommunications industry with the FCC.

The second concerns the line-of-business restrictions imposed on Southwestern Bell by the MFJ. We believe the forum for administering the MFJ should be changed from the decree court to the FCC, as called for in S. 2565.

The Communications Act charged the FCC with oversight of the Nation's communications industry. Although the courts are clearly the appropriate forum for the resolution of antitrust litigation, judges should neither set nor administer national telecommunications policy.

On the one hand, we have the FCC charged with implementing policy based on the public interest as defined by Congress. And the Commission's actions are subject not only to Congressional oversight, but to the judicial review as well. The appellate process affords the same level of judicial protection against improper decision-making as currently exists. On the other hand, we have the decree court with a more limited charter and not so clearly linked to the Congressional oversight process.

In its evaluation of policy proposals the court uses a more narrow antitrust criterion. Congress in its oversight capacity has a well-defined statutory responsibility for making sure the Commission is carrying out its public interest mandate. Under the present circumstance, the Congressional imperative is being thwarted. There is less public or political accountability for the results of decisions made by the court.

For us, changing the decree forum will mean a single source for Federal regulation rather than a multiple one, with multiple objectives, and no place to resolve different results.

The second pressing issue under discussion is removing the lines-of business restrictions imposed by the MFJ. Specifically, we refer to prohibition against our entry into long-distance competition, the delivery of information services, and manufacturing.

With respect to participating in competitive long-distance services, Southwestern Bell is not seeking immediate entry into that marketplace. What we do seek is the authority to make that business decision. The choice of whether or not to compete should be ours.

As to oversight of this service delivery, there are no regulatory bodies in the land with the expertise of the FCC and the State Regulatory Commissions.

Another area of critical importance to Southwestern Bell is freedom to enter the information services field. For example, the FCC has recently provided guidelines for our entry into the information services businesses, but we are still barred from doing so by the MFJ. And this is an example of dual regulation at its worst: That current prohibition denies our customers services they want and often cannot find anywhere.

The third freedom Southwestern Bell seeks is the opportunity to enter the field of manufacturing. While we have no plans at present to engage in broad-scale manufacturing, the decree's restrictions are general and undefined. As a result, any aspect of bringing a product to market is subject to question.

Finally, Mr. Chairman, I want to dispell some misconceptions surrounding the prospect of Southwestern Bell becoming involved in manufacturing. We ask only that Southwestern Bell be given the opportunity to compete on a national basis and on an equal footing with other companies.

We can assure this Committee that cross-subsidies will not occur. Consumer interests are adequately protected by the regulatory process. . .a process that prevents cross subsidies and predatory pricing.

Before I conclude, I want to clarify one point about why we support S. 2565. The bill in my judgment does not grant and should not grant the FCC blanket authority to extend common carrier regulation into non-common carrier lines of business. If it did, we would strongly oppose the bill.

We believe, however, the FCC should consult with other involved governmental sources before modifying the decree. Now is the time to enact legislation to solve the procedural gridlock created by the decree.

That consultation could come with the Justice Department on antitrust matters. . .and with the Commerce Department on trade and telecommunications policy.

Almost five years ago, Assistant Attorney General William Baxter appeared before this Committee and said, and I quote: "The Modified Decree does not, and is not intended to, resolve all of the regulatory or legislative issues that may exist in telecommunications now or in the future."

We agree. And now is the time to enact legislation to solve the procedural gridlock created by the Decree.

We look forward to working with you toward this goal.

Thank you.

(The following information was subsequently received for the record:)

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. If you are permitted to manufacture telecommunications equipment, will you manufacture domestically?

Answer. As stated in response to this inquiry from Senator Riegle during the hearing, ". . . it is difficult for me to speculate on that . . . we would be guided by the business climate that exists as to what is the best arrangement for our shareholder, and hopefully the climate in this country would be such that it would be conducive to our doing manufacturing here . . . And I believe that our stockholders' interest is broader than just a dividend or the growth of a stock."

To those comments we would add these further observations: The greatest potential short-run impact Southwestern Bell might have on the current trade deficit in telecommunications is to reduce the growth rate of imports. The reality is that the United States is by far the largest market for telecommunications in the world. The regional Bell companies alone represent markets larger than Japan, France, Great Britain and Germany combined. (See attachments 1 and 2, enclosed.)

We recognize this reality, just as the growing number of foreign-owned firms which have built assembly and warehouse operations in the U.S. recognize it. However, the current terms of the Decree actually prohibit any BOC manufacturing activity at any level of the process from occurring in the United States. The net effect is to limit BOC entry into manufacturing to offshore locations and remove from BOC management and owners the opportunity to explore domestic operations.

TABLE 1.—*Selected Major World Telecommunications Equipment Markets*

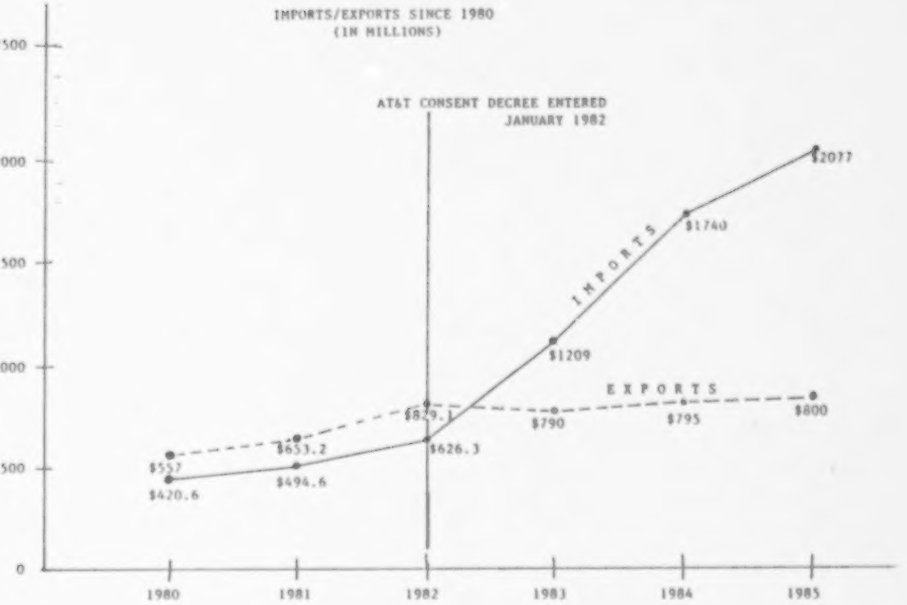
[In billions]

Market	*Size*
1 Japan	$5.5
2 France	3.8
3 United Kingdom	3.3
4 Germany	3.2
5 Bellsouth	2.5
6 Italy	2.3
7 NYNEX	2.1
8 Bell Atlantic	2.0
9 Pacific Telesis	1.9
10 Southwestern Bell	1.9
11 Ameritech	1.8
12 U.S. West	1.8

Source: Estimated by Southwestern Bell Corp. through data provided by NTIA, International Trade Commission and the U.S. Department of Commerce.

CHART 2
TELECOMMUNICATIONS TRADE

IMPORTS/EXPORTS SINCE 1980
(IN MILLIONS)



SOURCE: U.S. DEPARTMENT OF COMMERCE: BUREAU OF THE CENSUS, BUREAU OF ECONOMIC ANALYSIS, AND INTERNATIONAL TRADE ADMINISTRATION(ITA).

Question. Some have argued that the Bell Companies are in a rush to diversify and that they are more interested in becoming conglomerates than in providing good, low cost local telephone service. Would you care to comment on that?

Answer. The passage of time since divestiture has been marked by numerous efforts to distinguish the regional BOCs both from their previous roles in the old Bell System and as individual, separate commercial entities. These steps were of greatest importance to the investment community, elements of which initially appeared to view negatively Southwestern's commitments to its core business of providing high quality, low cost telephone services to its customers. Members of the Committee may recall characterizations of our company as the "stick-to-our-knitting" region. Well-managed, careful expansion of the business into communications fields where we have strengths and expertise is the plan we have employed and intend to maintain. That plan will work to the advantage of our telephone company customers because it acknowledges the telephone business as our greatest strength and source of expertise. All expansion since divestiture has occurred during a time when our telephone customers report increasing levels of satisfaction with their service. We are pleased that our recurring polling data among telephone subscribers is telling us that customer satisfaction is at an all-time high level, better than pre-divestiture. In the meantime, we are hearing no negative connotation from Wall Street about our approach to managing what we have or expanding it in the directions we've chosen.

Question. Is there a need to act quickly to life the line-of-business restrictions?

Answer. There is an urgency attending decisions about the forum for dealing with the public policy issues presented by the restrictions on our lines of business. Postponing Congressional action until next year will only serve to subordinate concerns these restrictions cause in such areas as international trade, domestic research and development investment, widespread deployment of information access and other facets of the public and national interest. Delay will cause a continuation of decision making by the Judicial Branch. Delay will foreclose business opportunities. But, delay will not make the right decisions more clear or any less complex.

Question. What will prevent the RBOCs from entering joint ventures with foreign companies or importing products which would be in direct competition with domestic manufacturers?

Answer. There is nothing present in this bill (S. 2565) to determine whether we should be allowed entry into domestic manufacturing. The bill seeks to place the question in a forum where the likelihood of competitive harm, if any, is asked in parity with questions concerning impact on labor, consumer, defense and other interests. And where questions of competitive harms resulting from continuing this restriction can also be raised and debated.

The question of joint venturing with some foreign-based firm seems curious. It seems to suggest that we would get the worst of any such arrangement we would enter. And it overlooks the high level of such joint venture arrangements which established U.S. telecommunications manufacturers have in place. The problem of imported products which compete with those of other domestic manufacturers has a far more likely outcome of retaining the status quo than it is of changing it.

Question. What provisions do we need to insure that more American jobs will not be lost in high technology areas?

Answer. We think the best assurance that "high-tech" jobs in general, and telecommunications jobs in particular, are not lost to other countries is to assure that American companies which are proven creators of such jobs are not artificially prevented from using their capabilities by our own government.

Question. The antitrust case against the Bell System can be regarded as a result of regulatory failure. The FCC was unable to prevent the Bell System from engaging in anticompetitive behavior. Would the FCC be able to prevent anticompetitive behavior if the line-of-business restrictions were lifted?

Answer. A large proportion of the 1974 government case against AT&T concerned matters outside the purview and authority of the FCC under the Communications Act. During the course of the case some allegations were raised concerning matters wherein the FCC had at least some authority, but government attorneys argued that acting under color of FCC order did not protect the company from allegations of antitrust violation.

S. 2565 seeks to consolidate the inquiry of competitive harm (the antitrust standard) and other inquiries, such as trade, employment, service, and others into a single forum exclusively for the purpose of managing the remaining elements of the AT&T and GTE Consent Decrees' provisions in ways beneficial to the public interest. The FCC would not be charged with new authorities to prevent anticompetitive conduct by the parties or others it regulates under the '34 Act. BOCs would continue to be subject to established antitrust laws. And enforcement authorities would be neither usurped nor duplicated by enactment of this bill.

Question. Have the Bell Companies satisfied the equal access requirements of the AT&T divestiture decree?

Answer. Southwestern Bell has exceeded the benchmarks required for conversion to equal access over the years since first established. At this time, we have converted all customer lines in all offices where required and where interexchange carriers have placed bonafide requests.* This meets the "conversion project" requirements of the Decree and has involved nearly three-quarters of all Southwestern Bell customer lines. The remainder are subject to conversion at such time as bonafide requests are made by interexchange carriers and serving central office switches are upgraded or replaced to provide the physical capability to handle equal access.

The CHAIRMAN. Thank you, Mr. Barnes.

Mr. McDonnell, is your view that there should never be any circumstance under which Bell Operating Companies manufacture equipment?

Mr. McDONNELL. There is one circumstance, and that is if their monopoly-controlled bottleneck facilities disappear. And there is every chance that that could happen. I do not see any technological improvement on the horizon that would cause that to happen, but in my opinion that is what will cause it to happen.

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* At this writing one such office in Leavenworth, Kansas, has not yet been connected due to a late request to serve the exchange by a competing interexchange carrier. This office will convert November 1, 1986.

The CHAIRMAN. Okay. Well, so long as the Bell Operating Companies maintain a monopoly control over the local telephone service, you do not think they should be in the business of manufacturing equipment?

Mr. McDONNELL. That is correct.

The CHAIRMAN. And you cannot see any way of monitoring or limiting what they could do that would relieve your concern? You favor an absolutely blanket prohibition; is that right?

Mr. McDONNELL. That is correct, which we have in other utilities for the same valid reasons.

The CHAIRMAN. Mr. Barnes, how do you respond to both Mr. McDonnell and to the representatives of the OCCs on the previous panel that the Bell Operating Companies are monopolies, that they have total control over local service and that therefore, if they were to get into the business of manufacturing equipment or providing long-distance service or information service, they necessarily would stack the deck in their own favor? It would be necessarily noncompetitive, and we would be right back in the situation we were in pre-AT&T divestiture except that there would be a regional split-up?

Mr. BARNES. Well, the fact that there has been a breakup of the Bell System and that there is an MFJ which governs the actions of the various former partners, clearly the one big factor that has broken the monopoly is the requirement to provide all interexchange carriers equal access to that local exchange network. So that to me there is no more argument about having a monopoly for a bottleneck purpose of precluding anyone's getting into that local exchange network.

By the same token, as far as information services are concerned the proceedings that are going on today before the FCC and the Computer Inquiry 3 will provide an assurance against any kind of an intra lata bottleneck for information services by advocating so-called open architecture of the network, of comparably efficient connections in the network for all competitors and through part X which provides the accounting fences around the various enterprises and exchange network to assure no cross subsidy.

So I think the arguments about bottleneck are outdated. And the facts simply speak for themselves that there is no monopoly bottleneck today with respect to information services or with respect to long-distance carriers entering that marketplace. So I do not think those arguments hold any water.

The CHAIRMAN. Let us suppose that Mr. McDonnell made some equipment that Southwestern Bell also made. Would he be disadvantaged in trying to sell that equipment to Southwestern Bell?

Mr. BARNES. It would strictly depend on the quality and the price. Our basic policy is and has been in our procurement division, our procurement organization, that we evaluate all products on a fair and business-like basis and those products which provide the quality we need at the best price are the products we purchase. And it would not make any difference whether we manufactured them or somebody else.

The CHAIRMAN. If you were manufacturing a product and Mr. McDonnell were and your purchasing people came to you and said, "Well, we have just bought this from Mr. McDonnell," you would not be sore about that?

Mr. **Barnes**. Not at all.

The **Chairman**. Senator Riegle?

Senator **Riegle**. Thank you, Mr. Chairman. Let me just start, Mr. Barnes, by asking you, have prices gone up or down for local service, since we have gone through the divestiture?

Mr. **Barnes**. Prices have gone up probably just slightly less than the CPI.

Senator **Riegle**. So what would that be, say, for the average user in your service district per month? Can you give me a measure?

Mr. **Barnes**. Yes. The average monthly bill for basic exchange service in Southwestern Bell Telephone Company serving area is roughly between $8 a month and $12.75 a month. That is for residential, single, flat-rate service.

Senator **Riegle**. That is the range presently?

Mr. **Barnes**. Yes.

Senator **Riegle**. What would it have been prior to the breakup?

Mr. **Barnes**. It would have been probably in the range of $6 to maybe $11.

[The following information was subsequently received for the record:]

As of	Low	High	Weighted average (month)
December 31, 1983	$5.05	$13.30	10.47
September 16, 1986	7.80	15.31	11.65

Senator **Riegle**. I know I am asking you this just off the top of your head, so if you want to give me the precise numbers for the record I would ask you to do that if they vary from what your estimates are here, but what has happened on the long-distance side?

Mr. **Barnes**. Well, I think generally long-distance rates have tended to come down.

Senator **Riegle**. Have they come down as much to offset this increase in the local service cost?

Mr. **Barnes**. I really do not know whether they have or whether they have not. I do not have a real feel for that. I think they are probably somewhat comparable.

Senator **Riegle**. Let me ask you, if you go into the manufacturing of telecommunications equipment, what is the likelihood that you would be doing it here in the United States with American workers versus getting involved in supply relationships with manufacturing entities outside the country?

Mr. **Barnes**. Well, I think it is difficult for me to speculate on that. But just making a couple of observations, it seems as if the tendency of American industry is to go offshore more and more with respect to manufacturing. I believe I read recently where AT&T is planning to open some overseas outlets I believe in Singapore or other locations.

So we would be guided by the business climate that exists as to what is the best arrangement for our shareholder, and hopefully the climate in this country would be such that it would be conducive to our doing our manufacturing here. But facing the realities of international trade and facing the realities of world-wide economics, I do not know exactly where we would go. We would go where we could maximize our shareholders' interests.

Senator **Riegle**. Well, that is a complex issue, and I appreciate the difficulty of it. You know, there are a lot of aspects to shareholder interest. I mean shareholders not only are interested in earnings and dividends, they are interested in what is happening in their communities. They are interested in whether they have jobs. They are interested in whether their kids have jobs.

I think we need more leadership on the business side in all sectors—I do not just single you out; I am going to make this point to all business people we talk to from now on—to see what we can do about creating more jobs in this country. I think it is now a matter of sufficient national urgency with a trade deficit of $175 billion to just shop offshore because it may have some perceived short-run economic advantage may in fact be bad long-run economics for a lot of reasons, for the county and eventually for industry sectors and finally for companies directly.

So we have had some leadership. I know the man that runs the Walmart Stores in the country has decided that he is going to feature American-made products and is doing so, and apparently it has not hurt him any. He seems to be doing well in terms of how that stock is valued and their sales performance and so forth.

And I guess I would just hope that whatever lines of business you find yourself getting into that more emphasis can be given to the question of how we try to do this work in the United States with American workers, create more national income production in this country, and more national wealth which in turn can be spent on telephone services among other things.

I am afraid if we all just think in terms of other things and that that just is left as a residual, which is more or less the way it has been now, we are going to take our situation where we are now the number one debtor Nation in the world, we are adding to that international debt to the tune of a billion dollars every two and a half days, I think we put ourselves in a situation where eventually everything gets diminished including your company and every other company.

So I hope that whatever develops here in the way of the evolution of your own industry that this will not be something that just gets swept to the side but is thought of as a very central question that has to do with how the country is doing as well as how the firm is doing.

Mr. **Barnes**. Yes. I certainly do not disagree with that. And I believe that our stockholder's interest is broader than just a dividend or the growth of a stock. I think it is interesting to simply note that today to purchase telecommunications hardware we are forced to go offshore because there is only one manufacturer in this country that produces that kind of hardware. And I think that kind of tells the story of what is happening with respect to manufacturing of telecommunications gear in this country.

Senator **Riegle**. Well, I think that is an important point. I think we are going to have to reverse that. When I look at the deficit figures in terms of telecommunications products, we are underwater there. In 1986 the estimate is that our deficit will be $1.6 billion. If you broaden it out to a broader gauge of electronics-based products, we had a surplus in that area of the trade account of $7.4 billion in 1980. We are now running a $16 billion deficit.

So there has been a real hemorrhage of that kind of activity out of the country, and it is a serious problem. I do not suggest that you can solve it by yourself, but I think it needs to get elevated if we are going to come in here to talk about problems that relate to this manner of business. This is a big part of the problem.

And we are going to have to find a way to change these trend lines. And I do not know who does it, whether it is the manufacturers who are here now or whether new people are going to have to come into the business. But I do not think it is sufficient for us to continue to see all this activity move offshore. And if the companies by themselves and the industries are not strong enough to start to reverse these trends, then they ought to speak to our Government about it and the President, the Secretary of State, Congress and others have some role to play if we are going through a national impairment of our manufacturing capability and everybody says, "Well, really I cannot do much about it."

Mr. **Barnes**. I would just make one other comment. The fact is that being precluded from being in manufacturing, we have very little ability to do R&D, research and development.

The facts are that research and development is going offshore in this country as well as the manufacturing. And I think that is a terrible tragedy that is happening, plus the fact that much of the sophistication that is already available in the local exchange network is being put in terminal devices offshore because we are precluded from being in the information business or being precluded from being in manufacturing and thus have no incentive to do research and development. So there is a lot more to it than just making hardware.

Senator **Riegle**. Mr. McDonnell, let me just bridge over to you on this question and then I want to ask one question of Ms. Easterling. And that is: How do we reverse this situation? They would like to get into the manufacturing business and they are not willing to say one way or the other whether to produce here or offshore, but how do we begin to address this problem? Whether they are in the act or out of the act, how do we start to see more forward progress, if you will, out of the industry that you are here speaking for?

Mr. **McDonnell**. Well, I think first we ought to set the record straight. There are over 500 U.S. manufacturers of telecommunications equipment, not just one. Most of those have come into existence since the 1968 Carter Phone decision by the FCC which started to permit people to attach their own customer premises equipment to the monopoly network.

Up until that time, that statement would be basically true. AT&T was clearly the dominant manufacturer of telecommunications equipment, and then each of the other monopoly carriers had some of their own manufacturing capability. But that situation is simply not true today. There are over 500, and this was shown in a study that was done at the International Trade Commission.

Mr. **Barnes**. Not switching equipment.

Mr. **McDonnell**. So it is a very robust domestic telecommunications market.

Senator **Riegle**. I heard Mr. Barnes say "not sourcing equipment."

How many are in the sourcing equipment?

Mr. **Barnes**. Switching equipment.

Senator **Riegle**. Switching equipment aspect?

Mr. **McDonnell**. Well in switching equipment there are—in fact, I can name them: AT&T, Northern Telecom, Incorporated——

Mr. **Barnes**. That is a Canadian company.

Mr. **McDonnell**. No, Northern Telecom, Incorporated, is a North Carolina-based U.S. manufacturer of switching equipment. And the AT&T.

There is also Digital Switch Corporation in Dallas, Texas, Rockwell, GTE, and of course there are also some other companies that are foreign-owned that have U.S. subsidiaries in the switching business such as NEC America, L.M. Erickson, Seaman's, all of whom have manufacturing here in the United States or they would not be eligible for membership in our organization.

The **Chairman**. Well, let me just say that when I am haranguing the Japanese and other countries about buying American telecommunications equipment, I do not express satisfaction when they say they are doing business with Northern Telecom; that is a Canadian company, not an American company.

Mr. **McDonnell**. Northern Telecom Limited is a Canadian company. Nothern Telecom, Inc. is a wholly owned U.S. subsidiary, headquartered in Nashville, Tennessee.

Senator **Riegle**. Northern Telecom, I gather—I am not intimately familiar with that company—I gather they produce some things in the United States and some in Canada; is that correct?

Mr. **McDonnell**. That is correct.

Senator **Riegle**. And I suppose in some other places. But we probably ought to get for the record exactly how much of their production is in the United States. And I would hope that it is increasing. I would hope that it is going up.

[The following information was subsequently received for the record:]

Northern Telecom Inc.,
Washington, DC, September 22, 1986.

Hon. John C. Danforth,
Chairman, Committee on Commerce, Science and Transportation U.S. Senate, Washington, DC.

Dear Mr. Chairman: During the September 16 Committee hearing on S. 2565, the Federal Telecommunications Policy Act of 1986, some questions were raised concerning the U.S. character of Northern Telecom Inc. and the location and extent of its facilities in the U.S.

Senator Riegle concluded the colloquy, which occurred during the panel consisting of representatives of Southwestern Bell, the Electronics Industries Association, and the Communications Workers of America, by suggesting that the record reflect "exactly how much of their [Northern Telecom's] production is in the U.S."

Northern Telecom Inc., a U.S. company chartered in Delaware, is the second largest manufacturer of telecommunications equipment in the United States. We have more than 20,000 employees throughout the United States in 15 manufacturing facilities and 15 R&D centers. The investment in the United States exceeds $1.5 billion. Only AT&T Technologies, the former Western Electric, manufactures more equipment in the U.S. than Northern Telecom, and Northern Telecom is the only company manufacturing telephone handsets in the U.S. since AT&T has moved its production overseas.

Our U.S. employees and facilities produce information and telecommunications equipment for U.S. telephone companies including all the Bell Operating Companies, corporations, the U.S. Congress and for agencies and departments of the U.S. Government. Our equipment is in use by the Department of Defense, U.S. intelligence agencies, and the White House. Last year we produced and sold as much digital switching equipment in the U.S. as AT&T.

As you are aware, the U.S. company was recently successful in being awarded a $250 million contract by Nippon Telegraph and Telephone for digital switching equipment which will be manufactured at and shipped from our facilities in North Carolina.

The U.S. company, which is a wholly-owned subsidiary of Northern Telecom Limited, a Canadian corporation, is now responsible for approximately 70 percent of the revenues of the global corporation. Products manufactured and sold in the United States or exported from Northern Telecom's U.S. facilities are more than 80 percent sourced domestically. A list of our U.S. manufacturing facilities is attached.

I would request that this letter be made a part of the hearing record.

Sincerely,

NORMAN L. DOBYNS,
Vice President, Public Affairs.

Enclosure.

Northern Telecom's major installations in the U.S., in alphabetical order, are:

Ann Arbor, Mich., where more than 300 employees work in a computer center and research and development installation.

Atlanta, Ga., where about 1,300 employees manufacture and market digital transmission equipment.

Concord, N.H., where about 450 employees manufacture data testing and communications network monitoring systems.

Dallas, Texas, where 1,700 employees work in several offices as well as a plant making very large private branch exchanges, and a second plant reconditioning computer equipment. Headquarters of Northern Telecom's Integrated Office Systems group is located in Dallas.

Marlton, N.J., where about 260 employees manufacture data test instruments and automated systems to maintain and administer data networks.

Minneapolis, Minn., where about 1,000 employees manufacture data and word processing equipment, including the Meridian DV-1 data voice system.

Moorestown, N.J., where about 350 employees manufacture data testing and communications network monitoring systems.

Morton Grove, Ill., where about 850 employees manufacture the supporting hardware used by telephone companies to interconnect their central switching centers to home and business locations.

Nashville, Tenn., where, in addition to the headquarters of Northern Telecom Inc., the company operates a terminal manufacturing plant. Total employment is approximately 1,300.

Raleigh-Durham area of North Carolina, with four manufacturing plants in the vicinity, where more than 6,000 employees manufacture digital central office switching equipment for telephone companies and switches for interexchange carriers. This is headquarters of the Integrated Network Systems group.

San Diego, Calif., where 350 employees design and manufacture semiconductor components in the company's integrated circuit plant.

Santa Clara, Calif., where some 1,200 employees manufacture digital business communications systems or private branch exchanges.

West Palm Beach, Fla., where 800 employees work in two plants manufacturing printed circuit boards and hybrid substrates.

Senator RIEGLE. Let me just raise one other thing here. I just want to make an observation about something that the people in the computer chip business have said to me when they have appeared before the Senate Banking Committee, Intel and others, to talk about the degree to which they are being impaired by international competition and being frozen out of foreign markets, and it relates to what the Chairman has just said.

They have testified before the Banking Committee, that industry and Silicon Valley in large measure, that they have been shut out of the Japanese market so long and so completely that they have been permanently impaired as companies, that they now have a built-in capital insufficiency and R&D underperformance that has accumulated over the years so that they feel now that they are not in the position to go head-to-head on a full-line basis with Japanese companies, and that they now have to look for market niches.

It was very striking testimony that we got from them to that effect that they feel that they now have been dwarfed in terms of their current capability in the future because of these entrenched market patterns where they have been denied their fair share of what they should have gotten in the Japanese market. It is very troubling. It is not clear exactly how we solve that now, but it certainly has a bearing I think on the future of this industry.

Ms. Easterling, if I have got your numbers right, you feel that there have been 33,000 jobs lost from AT&T since divestiture and about 60,000 lost from the operating companies. Did I get that right?

Ms. Easterling. Correct.

Senator Riegle. So that is roughly 100,000 jobs that have disappeared since that period of time. How sure are you of those numbers?

Ms. Easterling. Well, as I indicated in my testimony, the one figure was secured from the FCC, and the other are figures that have been provided to us by the industry.

Senator Riegle. How does the CWA feel about allowing the operating companies to get into manufacturing?

Ms. Easterling. Well, for a long period of time, we have been very much concerned with the definition of "manufacturing," and we have been seeking such a definition. We have been a strong supporter of the Chairman's bill, S. 942, and the companion bill in the House, but we too are concerned as to where the manufacturing will take place, who is going to do the manufacturing, and whether it is going to be in this country or elsewhere. We think that that is absolutely necessary, if any decision is going to be made, that that information should be made available.

We just think that we need to provide jobs in the United States. And one of the things with the telephone worker is that they are hit both ways. If you move his job or her job overseas, that is a job that is lost.

On the other hand, if the auto manufacturer moves the plant overseas, first the telephone worker takes the telephones out of the abandoned plant and then he takes them out of the auto workers' homes.

So we have been deeply affected by the trade situation and have been working very hard on securing passage of some bill and we feel very strongly that something must be defined more definitely, if we are to permit manufacturing.

Senator Riegle. And how about information services?

Ms. Easterling. On information services, we have taken—I do not want to say we have taken a position because we have not—we have commented that perhaps that would be the most reasonable avenue for the BOCs to move into.

Senator RIEGLE. So you would be open to that?

Ms. EASTERLING. We would be open to discussion on that.

Senator RIEGLE. And your view on just long-distance business?

Ms. EASTERLING. On the long-distance business, we are somewhat apprehensive about the long-distance business. One of the things that concern us is no matter where you spread it around, there is only so much long distance business. So if the BOC in fact was selling the long-distance service and AT&T were to lose that business, our employee would be lost to AT&T.

Somebody loses and right now we do not have the ability just to arbitrarily say to you that that person who would be laid off, for example at AT&T, would be employed at the BOCs. That is not the case.

Senator RIEGLE. Mr. Chairman, I may have some additional questions for the record. I would like to note that Senator Gore has been necessarily absent during most of these hearings because he is involved in the impeachment hearing that is going on with the Federal Judge and he has asked that I ask for him that his statement be included in the record and that his questions be submitted for the witnesses and answered also.

The CHAIRMAN. Fine.

Thank you very much for your testimony.

The final panel will be Mr. Uzal Martz, on behalf of the American Newspaper Publishers Association; Mr. Gene Kimmelman, Consumer Federation of America; James Fischer, Missouri Public Service Commission, on behalf of the National Association of Regulatory Utility Commissioners; and Ronald Stowe, Pacific Telesis.

Mr. Martz, would you like to go first, please?

STATEMENTS OF UZAL MARTZ, JR., PUBLISHER, POTTSVILLE REPUBLICAN, ON BEHALF OF THE AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION; GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA; JAMES M. FISCHER, COMMISSIONER, MISSOURI PUBLIC SERVICE COMMISSION, ON BEHALF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS; ACCOMPANIED BY BRUCE HAGEN, COMMISSIONER, NORTH DAKOTA PUBLIC SERVICE COMMISSION, CHAIRMAN OF THE NARUC COMMITTEE ON COMMUNICATIONS; AND RONALD F. STOWE, VICE PRESIDENT/WASHINGTON OPERATIONS, PACIFIC TELESIS GROUP

Mr. MARTZ. Mr. Chairman, and Members of the Committee——

The CHAIRMAN. If you could withhold, Mr. Martz, I am sorry. We will wait until the people have a chance to leave and get the doors closed.

Thank you, sir.

Mr. MARTZ. I appreciate the opportunity to appear before you today on behalf of the American Newspaper Publishers Association.

In the interest of time, I will quickly highlight my oral statement. I think one of the most important challenges facing the Senate, as it reviews the administration of the AT&T consent decree, is to assure the preservation of the decree's diversity principle. The diversity principle holds that companies possessing monopoly power over telephone communications should not be allowed to own or control the information carried on their monopoly facilities.

This telephone company monopoly power over the transmission of electronic information services is as strong now as it ever was. Accordingly, the reasons justifying an unequivocal retention of the diversity principle are just as compelling today as they were four years ago, when there were extensive legislative and judicial proceedings which resulted in the Senate adopting it in S. 898 and Judge Greene including it in the consent decree.

We commend the Chairman and this Committee for not being stampeded into this process and following a thorough process on the question of changes to the consent decree. The issues relating to the protection of ratepayers, enhancing competition, promoting international trade are no less complex today than they were four years ago, nor are they deserving of any lessened inquiry today than that undertaken in Congress and the courts which led the divestiture in the first place.

Certainly such enlightened inquiry and precision drafting of any legislation are essential to meeting your stated objectives that there can be no doubt as to what Congressional intent is on these issues in this area.

ANPA's position on these issues is based upon our total commitments to first the development of the best possible technology and services at the lowest cost; and second, to a full and freely competitive marketplace for electronic information services, and one that is characterized by a diversity of electronic information service providers.

In the first instance we recognize and support the key role of the BOCs in the development of sophisticated voice data networks for all users. However, in the second instance we firmly believe that in the light of the unchanged monopoly power of the telephone companies removal of the electronic publishing limitations on AT&T and those on the BOCs would unleash the risks of anticompetitive behavior and threaten the diversity of information services.

As more fully contained in our filings with this Committee in July and the written testimony in response to your questions leading to these hearings, ANPA proposes:

One, that any shift of the Consent Decree administration away from the antitrust court should include a firm statutory bar against monopolization of information content by the BOCs and AT&T. Such a statutory bar would be consistent with prior expressions of policy by the Senate. It would give the assurances of a freely competitive marketplace to both existing and potential electronic information service providers, and it would ensure that the FCC would be less likely to adopt conflicting policies.

Two, relief from the statutory bar would be based on an objective 75 percent market dominance test unrelated to any passage of time and not subject to undue administrative discretion. When a telephone company would have less than a 75 percent customer-based market share for local or long distance telephone service, it could be found to no longer have monopoly power. However, before it could then enter the electronic information services market, it would still be required to demonstrate that there is no substantial possibility that it could use its market dominance to impede competition and clearly defined protective safeguards would need to be met.

Mr. Chairman, we feel that the diversity principle remains the best guarantee of ensuring both a competitive marketplace and diversity of information sources for all consumers. ANPA's proposal enables the telephone companies to enter the marketplace when they no longer have a monopoly bottleneck and can demonstrate that there would be no danger of anticompetitive behavior in their capacity as a dominant carrier.

To these ends, we are confident that the Senate will maintain its leadership role on these issues, and we appreciate the opportunity to express our views.

[The statement follows:]

STATEMENT OF UZAL H. MARTZ, JR.

Mr. Chairman, members of the Committee, I appreciate the opportunity to appear before you today on behalf of the American Newspaper Publishers Association. ANPA, headquartered in Reston, Virginia, is a trade association representing nearly 1,400 member newspapers which account for about 90 percent of the total daily and Sunday newspaper circulation in the United States. Many non-daily newspapers also are members.

I. INTRODUCTION

Mr. Chairman, I come before you today to express ANPA's conviction that the protections for competition in electronic information services established by the Modification of Final Judgment should be preserved. In evaluating the pending legislation addressing the AT&T Consent Decree, ANPA is guided by the firmly held belief that the Congress must preserve the Diversity Principle. The Diversity Principle provides that monopoly telephone companies should not be allowed to own any interest in or control over the information which flows through their transmission facilities. Because AT&T and the BOCs continue to hold undiminished monopoly power, any shift of MFJ administration from the district court should include a statutory enactment of the Diversity Principle in the area of electronic information services.

The electronic information services industry is one of the most exciting and promising fields being developed today. Electronic information services can provide customers with news, political, editorial, advertising, product, service, financial, educational, literacy, transactional, sports and religious information. This new industry will combine high technology with home and office equipment to enable such information to be delivered at the touch of a home computer or telephone.

Electronic information services use a variety of different technologies, including voice storage and forwarding, mass public announcements, interactive voice response systems, electronic mail, transactional services, and specialized business and general consumer database services. The services can encompass a variety of value-added functions beyond the mere offering of information itself, including the packaging, classifying, sorting, brokering, and addressing of the information.

The one fundamental characteristic of electronic information services is their dependence for transmission upon the local and interexchange telephone network. The Diversity Principle recognizes that it is inherently anticompetitive and ultimately dangerous to permit monopoly telephone companies to own any interest in or control over electronic information which is transmitted over their transmission facilities. The Diversity Principle embodies the sound antitrust considerations which recognize the potential for anticompetitive abuse by the owners of essential monopoly facilities when such owners also compete with those who must use the facilities. And, as you know, Judge Harold Greene incorporated the Diversity Principle into the MFJ, prohibiting the BOCs and AT&T from providing electronic information services.

These abuses which may occur absent the Diversity Principle include the ability of AT&T and the BOCs to discriminate against unaffiliated electronic information service providers. For example, a carrier might fulfill service orders for its affiliate more quickly than for competitors or it might assign maintenance and repair work in a preferential manner. AT&T and the BOCs also can cross-subsidize the operations of the electronic information affiliate with revenues derived from ratepayer payments. The cross-subsidization can take very subtle forms, including transfers of personnel with critical knowledge obtained at ratepayer expense. Overall, the BOCs and AT&T are able to use a substantial amount of information derived solely from their monopoly operations—about technology, customer proprietary network information, marketing—giving an unfair advantage to their electronic information services.

Mr. Chairman, the ANPA remains committed to a telecommunications public policy that fosters a diversity of information sources and full competition. It was in furtherance in these goals that, five years ago, the ANPA embraced the Diversity Principle, which provides that: "Telephone companies which control transmission facilities should be barred from originating; controlling, or having any interest in, the information content transmitted over those facilities."

We believe that the Diversity Principle is alive and has worked well, and that there has been a significant increase in the range of available electronic information services during the past several years. However, much remains to be accomplished.

We believe that the Diversity Principle promotes this nation's First Amendment policies. As you know, the Supreme Court has recognized that: "[t]he widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public, that a free press is a condition of a free society."

The First Amendment, as Judge Learned Hand observed: "presupposes that right conclusions are most likely to be gathered out of a multitude of tongues, than through any kind of authoritative selection. To many this, and always will be, folly; but we have staked upon it our all."

It is clear that an underlying policy of the First Amendment is to promote diversity and competition in public voices. This policy, reflected in the Diversity Principle, must play a central role in any legislation affecting BOC or AT&T entry into electronic information services.

The Diversity Principle is necessary because the electronic information services market is very fragile. These services are highly sensitive to any delay in delivery and any degradation in quality. Electronic information services are just beginning to establish themselves, and they can easily be crushed by AT&T and BOCs. Once crushed, these services are not likely to rise again, and a critical diversity in voices will be lost.

It would be inaccurate to believe that the First Amendment and public policy considerations that mandate diversity in the telecommunications marketplace are limited only to news and editorial information. The U.S. Supreme Court has held, in cases such as *Virginia State Board of Pharmacy* v. *Virginia Gateway Consumer Counsel,* that the free flow of information is equally as important when it concerns commerce as when it involves news and political opinion.

As we all know, consumers may now obtain a wide variety of information regarding such matters as legal services, real estate, medications and utility services. These diverse sources of information allow the marketplace to flourish, and expand the range and prices of available services—all to the ultimate benefit of the consumer. And, in addition, a competitive marketplace for electronic information services will lead to the lowest cost of the American consumer for these services.

The Senate itself previously has expressed its commitment to the Diversity Principle. In 1981, the Senate passed S. 898 which by its terms embodied the Diversity Principle. This Committee made clear in the report accompanying the bill that it was concerned about the combined control of telephon exchange facilities and information content or access. This concern was addressed by barring AT&T and its affiliates (which then included the BOCs), from the provisions of "mass media services" over their own lines.

In turn, in 1982, the Diversity Principle was incorporated into the settlement of the federal antitrust suit against AT&T. Under the MFJ, the BOCs and their affiliated enterprises are prohibited from providing "information services," defined as the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, or utilizing, or making available information which must be conveyed via telecommunications. AT&T is prohibited from engaging in electronic publishing over its own transmission facilities at least until August 24, 1989. "Electronic publishing" is defined in the MFJ as the provision of any information which a provider or publisher has, or has caused to be, originated, authored, compiled, collected, or edited, or in which it has a direct or indirect financial or proprietary interest, and which is disseminated to an unaffiliated person through some electronic means. Judge Greene has treated electronic publishing as falling within the definition of information services.

Judge Greene has made clear on a number of occasions that the BOC information services prohibition is one of the core MFJ restrictions. It was deemed necessary because otherwise the BOCs would have the incentive and the ability effectively to discriminate against competing electronic information providers. Similarly, given AT&T's domination of the interexchange market, the MFJ Court found that competitive considerations necessitated AT&T's substantial exclusion from the electronic publishing field.

The BOCs and AT&T were excluded from information services and electronic publishing, respectively, both to prevent anticompetitive conduct by the telephone companies having a monopoly of the transmission facilities and for an additional reason unique to the electronic information services area. Specifically, these services raise substantial First Amendment concerns, as I have previously discussed. The MFJ Court concluded that domination of electronic information services by the BOCs and AT&T, as a result of their control over critical transmission facilities, was a very real danger that threatened the diversity of information sources otherwise fostered by First Amendment policies.

ANPA continues to believe that the MFJ Court is the most apropriate forum for administering the provisions of the MFJ. However, if the Congress should transfer jurisdiction to the FCC, it is critical that the Diversity Principle be preserved. The best way to achieve this goal is through enactment of a statutory ban on BOC and AT&T provision of electronic information services.

II. THE NEED FOR A STATUTORY BAR ON BOC PROVISION OF ELECTRONIC INFORMATION SERVICES AND AT&T PROVISION OF ELECTRONIC PUBLISHING

Given the significance of electronic information services as sources of information to the public, as I described previously, the Congress must take care to ensure that these services, and especially their information content, are not dominated by one company. At present, the BOCs and AT&T retain effective monopoly control over facilities critical to the provision of electronic information services. In light of this continuing monopoly domination of transmission facilities, because alternative safeguards are not adequate protections, and because the FCC has shown a predisposition toward removing the electronic information services restrictions, it is necessary to enact the restrictions on BOC provision of information services and AT&T provision of electronic publishing into law if administration of the decree is removed from the federal district court.

A. The BOCs and AT&T Retain Monopoly Control Over Bottleneck Facilities Critical to Electronic Information Services

The BOCs were barred by the MFJ from the information services marketplace because of the dependence of such services on the bottleneck local exchange network; if they were not excluded, according to the MFJ Court, the BOCs would have both the incentive and the opportunity to promote their own information service activities at the expense of competitors. Nothing has changed about this situation—the BOCs retain control of local exchange facilities, and information services remain dependent on local exchange facilities.

The BOCs repeatedly have claimed that they now face competition and that their bottlenecks have dissipated. Anyone subscribing to local exchange service, whether a home consumer or large user, can tell you how much competition there is for local telephone service—virtually none. The unchanged monopoly situation has been confirmed by a number of observers in recent months. Judge Greene found in an opinion earlier this year that "the 'bottleneck' monopolies continue to exist as before," and "the ability to exploit the bottlenecks anticompetitively has remained precisely the same." Likewise, the Department of Justice, in a filing with the FCC regarding the agency's proposal to allow the BOCs to provide customer premises equipment without structural separation, stated in May of this year that "the great majority of telephone customers have no option other than the local BOC for exchange service and exchange access." The Department also indicated that it was not aware of *any* evidence before the FCC that would support the BOCs' claim that they have experienced a substantial loss of their monopoly power over local exchange services. The GAO, in a report to the Congress released in August, has determined that bypass is very limited, the most local telephone customers do not engage in bypass, that bypass systems carry a minimal amount of traffic, and that customers with bypass systems still obtain most of their telecommunications services from the local telephone companies.

Although a number of states have enacted so-called deregulatory statutes authorizing state regulatory commissions to deregulate competitive telecommunications services, our review indicates that no state has deemed it appropriate to cease all regulation of local exchange services. The monopoly held by the BOCs in many cases is mandated by state law. There can be no dispute that, for purposes of electronic information services, the BOCs retain a monopoly over local exchange facilities.

AT&T continues to dominate the interexchange market, particularly in the provision of transmission services needed by electronic publishers. Providers of electronic information services require access to a network that reaches throughout the country and that makes available high quality transmission capacity without excessive congestion and at reasonable rates. The alternative interexchange carrier networks have not yet reached the stage of development where they can serve as adequate substitutes for AT&T's offerings. Thus, AT&T's monopoly position in the interexchange services market remains little changed.

The FCC has confirmed this observation in its decision in the Third Computer Inquiry earlier this summer. In determining that AT&T should comply with the CEI requirements, the agency found that "AT&T's presence is still sufficiently strong in interexchange basic service markets" that it could distort competition in the enhanced services market.

B. The Diversity Principle Embodied in the MFJ Has Encouraged Development of Competitive Services

The Diversity Principle, as implemented in the provisions of the MFJ, is working well. As I described earlier, we have seen the emergence of a broad range of electronic information services that depend upon the telephone network. Despite these developments, I must acknowledge that the electronic information services market has not developed as quickly as once anticipated, particularly with respect to consumer-oriented services. Cost to consumers, both of the information and the equipment, has deterred use. Now, however, personal computers are declining in price and more consumers are becoming familiar with their use. At the same time, information providers are becoming more sophisticated in developing services to meet actual business and home needs and in marketing those services. In any event, the slower rate of growth cannot be attributed to the lack of BOC or AT&T participation in the market as information providers over telecommunications facilities. If anything, the current blossoming of services offered by an ever-increasing number of providers would not be possible of the BOCs and AT&T had been allowed unfettered entrance into the market.

I think that if I identify some of the electronic information services now available, you will see how successfully the Diversity Principle is working. Please keep in mind that I am providing you with a sample picture—I simply cannot include an exhaustive listing here.

First, we have database services. Both consumers and professionals can subscribe to a range of specialized data base services offered by companies such as Dun & Bradstreet, Dow Jones & Company, and Mead Data Central Corporation to obtain information ranging from updates on current events to stock quotes to legal research. These services can be accessed via personal computers, with the local telephone network serving as an important link in the transmission of these services to both homes and businesses. An example of a small but growing videotex service is Startext, offered by the Fort Worth Star-Telegram. The service provides updated news, closing stock prices, classified ads and electronic mail 24 hours a day to personal computer users in the Dallas/Fort Worth area. The subscriber rate is $7.95 per month.

Second, an increasing range of transactional services are becoming available. For example, today, a consumer can transfer money between bank accounts, pay bills, learn his account balance, or enter a stock order, all without ever leaving home. Simply by equipping his personal computer with a modem, the everyday consumer can engage in many banking financial and other transactions. The number of households subscribing to home banking services has increased substantially in the past two years—from 17,000 in mid-1984 to 80,000 in February of 1986.

A broad range of electronic information services also has developed to serve air travelers. It is now possible to check on airline flight schedules, make a reservation, and order a ticket by utilizing a home computer or touch tone telephone. TWA, for example, offers Travelshopper, which provides on-line reservations and ticketing, as well as information concerning hotel and car rentals. Consumers also can check flight schedules and make reservations through an interactive voice response service currently offered by People Express.

Third, there are mass announcement services, also known as Dial It services. Throughout the country, there are special numbers which consumers can call to listen to a weather report, a sports score, a stock quote, a children's story, a joke or a horoscope. Again, like all the services I am discussing, these mass announcement services rely upon the local telephone network as the transmission conduit. Since divestiture, there has been significant development in the Dial It services market, and this rate of growth is expected to continue into the future.

Fourth, in addition to the voice storage services previously discussed, there are a wide variety of other services involving the storage and retrieval of information. These services are available today to meet business and consumer needs, and include telephone answering machines, telephone answering service bureaus and voice mail devices that stand alone or can be integrated into a customer's PBX.

Many of these voice storage offerings give a provider an interest in or control over the content of the information. For example, voice storage is an integral part of the Dial It service, which provides sophisticated information in audio form to consumers. Voice storage can also include a packaging, brokering, sorting, classifying or addressing component. Currently, a telephone company serves only as a conduit for these voice storage services.

Fifth, these new electronic information services are not just being provided to the home and the office but also include what are known as public access or kiosk services. Increasingly, consumers are able to access guides to restaurants, theaters, shopping directories, transportation services and local events through terminals located at shopping malls, hotels and airports. Many of the more advanced and sophisticated public access services require transmission by the local telephone network.

Sixth, electronic mail allows a subscriber to send information from a computer terminal via telephone lines to an electronic "mail box," where that information is stored until retrieved on the terminal of another subscriber. Such a service is an alternative to systems such as telex, facsimile, mailgram, and courier services.

I think that you will find interesting a recent article from Business Week, which I have attached to my testimony. It provides additional information about the emerging electronic information services industry and the range of services available to the public. It notes that there are over 1400 firms involved in the electronic information services business. These companies run the gamut from large (such as Reuters, Dun & Bradstreet, Dow Jones, and McGraw-Hill) to small (such as Lloyd's Maritime Data Network, Metromail Corporation, and Certified Collateral Corporation). As this listing suggests, entrants into this market are not limited to newspapers but include a wide range of others. The article makes clear my point that the industry is beginning to thrive but is in a sufficiently youthful stage that protection from domination is still necessary. The Diversity Principle as embodied in the MFJ in large part is responsible for allowing the development of this industry with a diversity of services and a multiplicity of information providers.

C. The Proposed Additional Safeguards Are Not Adequate to Prevent Monopoly Control of Electronic Information Services

Senator Danforth has suggested a number of possible safeguards to be imposed on the competitive ventures of the BOCs. Specifically, Senator Danforth has requested comment on possible safeguards and related concerns in the following areas: accounting and cost allocation; auditing; transfer of assets; network information; customer information; nondiscriminatory access and interconnection; financing; and separate subsidiaries. Later in my testimony, I will address specific questions raised by Senator Danforth regarding safeguards in these areas. Now I would like to discuss ANPA's position that the safeguards suggested for consideration are not adequate protection for electronic information services against anticompetitive domination by the BOCs and AT&T while they retain the monopoly positions.

Simply put, all these "safeguards" can be manipulated and even abused to enable the BOCs and AT&T to favor improperly their own information services operations to the detriment of competitors and at the expense of the public. Accounting requirements are highly susceptible to manipulation. The telephone companies, for example, can engage in strategic costing to produce the desired result. Decisions about allocations of joint and common costs also create opportunities for cross-subsidization. Accounting requirements fail to prevent cross-subsidization because the overall accounting system is within the control of the BOC.

Dissatisfaction with accounting safeguards years ago led the FCC to adopt separate subsidiary requirements. Even separate subsidiaries, however, cannot prevent anticompetitive abuses; the BOCs simply resort to more subtle means, such as the fashioning of technical standards and the timing of new service offerings in a manner to favor the electronic information services subsidiary.

Similarly, network and customer information disclosure rules can be manipulated. Moreover, as I will describe later, there is some doubt that current FCC rules would be even minimally adequate to protect customer information and to afford competitors with equal access to both network and customer information.

Finally, requiring equality of technical interconnection does not remove the ability of the BOCs and AT&T to undertake a full range of anticompetitive behavior. For example, a BOC could schedule maintenance work to aid its affiliated information services operations. Other activities like the ones I have just described also would not be barred simply through interconnection requirements. In addition, the FCC's proposals for comparably efficient interconnection and open network architecture do not in fact expressly guarantee equal access to the network for competing electronic information services. Instead, the BOCs and AT&T may be positioned to argue that inferior interconnection provided to competitors is the best they can do.

Nor is there reason to believe that, even if the most frequently mentioned safeguards could effectively protect competition as a practical matter, the FCC and the carriers would cooperate in ensuring that that would be the case. Rather, in the Third Computer Inquiry decision—discussed by Chairman Fowler as providing an alternative to the MFJ prohibitions—the FCC already has moved to entrench certain monopolistic advantages of the carriers in the provision of competitive services, rather than decreeing the establishment of a level playing field. For example, the FCC has specifically permitted AT&T and the BOCs to extend their monopoly perogatives into competitive service markets by declining to mandate economically equal interconnection for other information service providers. Rather, the agency has permitted AT&T and the BOCs to assess distance sensitive transport charges for interconnections to their network, thus retaining the benefits of co-location, and hence a pricing advantage in the offering of an information service, despite the fact that such advantages derive solely from their long-protected monopoly status.

Similarly, the FCC has permitted AT&T to have preferential access to customer proprietary network information it gathers as part of its provision of basic transmission services for its customers. Although competitive information service providers must obtain a customer's written consent before obtaining access to such information, AT&T's competitive service operations will have access to that information unless the customer affirmatively acts to prevent such disclosure. These examples of double standards in treatment of AT&T and the BOCs versus competitive service offerors seriously undermine any confidence that the FCC might actually be committed to the etablishment of full and fair competition.

Evidently, neither AT&T nor the BOCs are committed to that concept. Thus, AT&T has already petitioned the FCC to exempt it from the equal interconnection requirements of the Third Computer Inquiry regime. Similarly, a number of the BOCs have petitioned for reconsideration of the Third Computer Inquiry decision and are seeking such flexibility in the definition and implementation of equal interconnection as to render the concept anything but equal. For example, BOCs have requested that they be permitted to decide unilaterally which services will be provided with equal interconnection, when interconnection will be implemented, and how it will be implemented. They have further requested that their equal interconnection proposals be permitted to go into effect and that they be permitted to begin offering services utilizing those proposals prior to public comment or testing of the proposals to determine their adequacy. Although the FCC has not yet acted upon these petitions, their very existence suggests that stronger rather than weaker safeguards are necessary to overcome the recalcitrance of the carriers to permit competition on equal terms.

Congress should not forget that a major factor in the district court's choice of MFJ enforcement procedures was the history of inadequate and ineffective regulation of AT&T by the FCC. Testimony at trial from two former chiefs of the FCC's Common Carrier Bureau confirmed that the agency has not been capable of effective enforcement of the laws regarding AT&T's behavior. Today, the limitation on FCC enforcement abilities are only exacerbated by the existence of 22 companies (21 BOCs and AT&T) to be regulated, rather than one. In a time of budgetary limitations, the FCC is poorly positioned to administer an antitrust decree that in part arose from its own inadequate performance.

Judge Greene himself recently confirmed this assessment of the FCC's capabilities in this field, in a speech delivered in June 1986 to the CSIS Congressional Study Group on International Information, Communications and Microelectronics. He observed that the antitrust suit against AT&T had been brought in large part because of the FCC's failure "for 15 or 20 years to detect cross-subsidization within AT&T, to prevent anti-competitive behavior, and to establish effective remedies." Judge Greene noted that the FCC has a relatively small staff compared to the "giants" it must regulate. Finally, he concluded that "the philosophy of the FCC is not primarily that of the antitrust laws which generated the AT&T decree, of effective controls to make sure that a powerful corporation will not overwhelm the interest of the smaller competitors and of the public."

D. The Congress Should Give Clear Policy Direction to the FCC and Limit Its Discretion in This Area

While ANPA believes that Judge Greene has administered the MFJ properly and with due respect to all competing factors, and should continue to do so, if the Congress does shift the MFJ responsibilities to the FCC, it must give the FCC clear policy guidance and limit agency discretion to emasculate the Diversity Principle. Congressional imposition of a statutory bar will ensure that the Commission cannot subvert the intent of Congress regarding the implementation of the Diversity Principle. Access to high quality, efficient, and affordable telecommunications services is a critical issue today, currently surrounded by a great deal of controversy. It thus becomes essential for the Congress to make clear to the FCC that the Diversity Principle ranks high among the goals to be pursued in national telecommunications policy.

At this time, there is substantial doubt as to the commitment of the FCC to the enforcement of the Diversity Principle. Statements by FCC Commissioners and staff have made clear their desire to eliminate all of the line of business restrictions, including the information services prohibition, regardless of the likely anticompetitive consequences. Thus, for example, at the open meeting on May 15, 1986, where the FCC adopted its Report and Order in the Third Computer Inquiry, Chairman Fowler described the MFJ's line of business restrictions on the BOCs as a "huge roadblock which still lies ahead" which "all of us here, my fellow commissioners, agree that this roadblock must be removed in the public's interest." Similarly, Commissioner Dennis Patrick on two occasions in June 1986 delivered speeches in which he stated that "as long as the MFJ bans the BOCs from providing information services, the full potential of Computer III—new services, low prices and contribution to network expenses—cannot be realized."

These statements, and others like them, at the very least strongly suggest that the FCC already has formulated preliminary conclusions. The agency clearly does not hold the same strong commitment to the Diversity Principle that the Senate has evidenced (for example, in its passage of S. 898 in 1981). It thus becomes even more critical than usual for the Congress to provide clear guidance to the FCC on appropriate policy, to help ensure that the FCC will not thwart its intent to establish the Diversity Principle. The best way to do this is to enact the Diversity Principle into law.

III. ENTRY INTO ELECTRONIC PUBLISHING BY AT&T AND THE BOCS SHOULD BE TIED TO AN OBJECTIVE MARKET TEST

As I mentioned before, the BOCs and AT&T routinely contend that they lack market dominance. The disparity between the views of the telephone companies and the reality of the telecommunications market underscores the need for an objective test to measure the monopoly power held by AT&T or the BOCs. An objective test could go far towards dispelling the myth of market non-dominance so widely argued by the telephone companies.

With respect to electronic information services, ANPA believes that the critical issue is the existence of a genuine choice of carrier for the provider and for the customer. We anticipate that concerns regarding the anticompetitive tendencies of AT&T or the BOCs should diminish when electronic information service providers and customers may freely choose their carriers. An objective market test must focus on the existence or not of a genuine choice—it must measure the extent to which alternative carriers of interchangeable transmission quality are available.

ANPA believes that the current line of business waiver petition process works reasonably well. However, the proposed legislation before this Committee would shift administration of the MFJ away from the antitrust court to an agency with no special mission or expertise in anti-trust matters. Ironically, the FCC has repeatedly disclaimed enforcement of the antitrust laws in favor of other governmental agencies. Only last May, in addressing concerns that a potential merger would allow an anti-competitive flow of information between competitors, the FCC stated that "we leave the enforcement of the antitrust laws in such instances to DOJ and the courts." More generally, I would note that the FCC has stated that to the extent its policies cover areas affected by the antitrust laws, agencies such as the Justice Department or the Federal Trade Commission "have primary enforcement responsibility."

Under these circumstances, ANPA believes it is not only appropriate but essential that Congress establish an objective standard, measured by dominance of local and interexchange service, to govern the prospective entry by AT&T or the BOCs into electronic information services. Leaving custody of the Diversity Principle in the inexpert and unrestrained hands of the FCC can lead only to the Principle's eventual demise.

A. The Relevant Markets To Be Examined for Dominance Are Local Exchange and Interexchange Service

The MFJ decree provides that, with respect to electronic information services, the relevant markets for analysis are those in which the BOC or AT&T operates. The MFJ requires a BOC seeking to provide an information service to demonstrate the absence of a "substantial possibility that it could use *its* monopoly power to impede competition in the market it seeks to enter." The MFJ similarly prohibits AT&T from engaging in electronic publishing over its transmission facilities.

We believe that both provisions properly focus primary attention on the telephone company's own market, for the reasons that lie at the heart of the MFJ. The anticompetitive conduct which the prohibitions attempt to forestall would arise from the telephone company's control over essential transmission facilities. For example, as the federal district court found, the BOCs "could discriminate by providing more favorable access to the local network for their own information services than to the information services provided by competition." Similarly, the court found that AT&T would have "both the incentive and the opportunity" to favor its own electronic publishing operations through its development of technology, facilities, and services.

As I mentioned previously, nothing has occurred to alter the paramount importance of the local exchange and interstate markets. Although the incentive for AT&T or the BOCs to favor their own operations may arise in an electronic information services field, the opportunity to do so remains at the local exchange or interexchange facilities level. Those, therefore, are the markets that should be measured. The appropriate market in considering AT&T is the interexchange telecommunications market throughout the United States. In the case of the BOCs, the relevant market is local exchange service in the areas in which the petitioning RBOC provides service.

Because AT&T and the BOCs retain monopoly control of the essential facilities, ANPA believes that the degree of competition in the particular electronic information service has only limited significance. Although the MFJ decree refers to the level of competition in the information services market when it speaks of a BOC's ability to impair competition, that inquiry is only a secondary concern. The MFJ's primary focus, by its own terms, is whether the petitioning telephone company possesses monopoly power in the market in which it provides transmission facilities.

We believe that this focus is correct. In the current electronic information services marketplace, where competition—even if lively—consists of relatively new, less well-established companies, a BOC could quash competition with ease. Even firmly-established competitive electronic information service providers are potentially vulnerable to a carrier upon whose facilities they are dependent. The carrier's own dominance remains unavoidably the prime source of concern.

B. Market Dominance Exists Where One Telephone Company Serves 75 Percent Or More of the Market

ANPA's fundamental goal is to ensure that electronic information providers have economic and effective access to alternative transmission facilities before AT&T or the BOCs are allowed to offer electronic information services. The Diversity Principle requires that a dominant carrier should not be allowed to provide electronic information services. A genuine choice of transmission facilities should be a precondition to any relaxation of the bans imposed by the MFJ.

Market dominance lends itself to measurement by an objective, unambiguous test. To this end, ANPA recommends that any legislation that is enacted should specifically provide that a telephone company has market dominance where it serves 75 percent or more of the customers in the relevant geographic markets for local exchange telephone service or interexchange telephone service.

Market power is defined as the power to control prices or exclude competition. Antitrust courts have generally found that market shares of more than seventy to eighty percent will support an inference of market power. ANPA believes that its proposed statutory threshold, which lies midway in that range, is reasonable.

The Congress can reasonably provide that, at least in this context, control over 75 percent of the market confers the power to exclude competition by discriminating against rival electronic information providers. It is worth noting that all of the BOCs currently exceed that level, and none yet faces any meaningful competition in local exchange service. Although AT&T is now facing some competition, it is still insufficient. A dominant telephone carrier having a presence of that size in the market may readily discriminate against rival electronic information providers and otherwise thwart the emergence of competitors. We believe, therefore, that Congress should adopt the 75 percent share of the customers as a clear, objective standard for evaluating BOC or AT&T efforts to provide electronic information services.

Telephone company market dominance should be determined by measuring customers to whom alternative delivery means are readily available, rather than revenues. Measuring the number of customers directly measures access to customers—the underlying goal. By contrast, we believe that a test based on revenues could be misleading; a few large customers with relatively large volumes of local or interexchange traffic could have a distorting effect. Isolated pockets of disproportionately large traffic might be profitable for scattered information providers, but the dangers of monopolistic behavior can subside only after an alternative system of access is well-established. Information service providers are as likely to target small users as they are large users.

A 75 percent statutory threshold would not be unrealistic. Although no carrier yet meets that measure, we must observe that interexchange competition has already begun to grow with the advent of equal access, and local exchange competition may likely develop down the road.

Once a telephone company's share of the relevant market falls below 75 percent, ANPA foresees less need for an absolute prohibition. However, Congress should be mindful that, as courts have recognized, monopoly power in the telephone industry may arise for other reasons, including regulatory delays, the need for large capital outlays, entrenched brand-name loyalty, and access to essential technical and marketing information. We believe that, in recognition of these obstacles, Congress should require a BOC having less than 75 percent of the market to bear the burden of demonstrating that its entry into electronic information services would present no substantial possibility that it could use its dominant market position to impede competition in the market it seeks to enter. This test is not new; it merely codifies the MFJ's test with which the carriers are already familiar.

As for AT&T, the MFJ's restrictions will expire in 1989 if the Court finds that competitive conditions so require. For the reasons I will discuss more fully in a moment, we believe the use of a fixed date is inferior. Instead, the possible entry of AT&T into the electronic services market should turn on the presence of competitive conditions in the interexchange market. AT&T's possession of less than a 75 percent share of the market should, as with the BOCs, serve as a preliminary threshold. If AT&T's share falls below 75 percent, competitive conditions should be analyzed to determine whether a continuation of the ban would be appropriate.

To ensure that no substantial threat to competition exists under the proposed test, Congress should establish the standards by which a carrier having less than a 75 percent market share may demonstrate its inability to abuse its power. ANPA believes that the carrier could make this showing by demonstrating that:

> (1) all electronic information service providers can, via an open network architecture, obtain equivalent interconnection to the local exchange network;
>
> (2) equal interconnection is available on an unbundled, tariffed, element-by-element basis;
>
> (3) all network-related information, including technical and subscriber data, is available to all electronic information service providers on the same terms as to the carrier's own operations;
>
> (4) all information derived from telecommunications operations, such as subscriber names, addresses, billing history, etc., is made available to all providers on the same basis as to the carrier's operations;
>
> (5) accounting and independent auditing procedures are in effect, with active regulatory oversight;
>
> (6) the carrier's transmission facilities are available on a non-discriminatory unbundled basis;
>
> (7) all network services are available on a non-discriminatory basis; and
>
> (8) customer proprietary information possessed by the carrier is withheld from the carrier's electronic information operation.

If these criteria are met, we think that the dangers of anticompetitive conduct, where the carrier has less than a 75 percent market share, would be greatly reduced.

By contrast, the creation of a specific date at which time the prohibitions applicable to AT&T and the BOCs would expire is less desirable. ANPA is not seeking a headstart for electronic information providers over AT&T and the BOCs, but rather a genuine competitive marketplace. A fixed expiration date is inherently artificial and would take effect without regard to market conditions at that time. We believe that a fixed deadline would merely postpone future problems, rather than prevent them.

For example, if the BOCs or AT&T know that they may enter the information services market at a certain date, regardless of their degree of monopoly power, they will have no incentive to take steps today to facilitate competition in the electronic information services market. Instead, they would have both the incentive and the opportunity to design their networks to favor their own future services. Consequently, a policy based on a fixed deadline would likely defeat, rather than encourage, the emergence of a truly competitive electronic services market.

I should note that ANPA is not inflexible regarding the details of the appropriate test. We will consider any reasonable alternative proposal that will advance the goals of the Diversity Principle. We would insist, however, that an alternative plan should be objective, unambiguous and not difficult to administer.

IV. RESPONSE TO SPECIFIC QUESTIONS AND ISSUES RAISED BY SENATOR DANFORTH'S PROPOSED AMENDMENTS

Finally, I would like to respond to certain issues and questions raised by Senator Danforth's proposals for amendment of S. 2565.

A. Findings

Senator Danforth has specified three findings to be included in the legislation. We urge inclusion of a fourth finding, one that makes effective implementation of the Diversity Principle a goal of the bill. This would help to make clear to the FCC that this is an important element of the national telecommunications policy adopted by the Congress and to be carried out by the FCC.

B. Petitions for Waiver

Evaluation of petitions for waiver, modification or elimination of the information services prohibition (for the BOCs) or the electronic publishing restriction (for AT&T) should be guided by the current MFJ criteria. Reliance on an amorphous "public interest" standard affords the FCC too much discretion to eliminate these electronic information services restrictions even if not warranted by competitive conditions. Rather, the Congress should make clear that, if the FCC is granted jurisdiction, the agency must find that there is no substantial possibility that the petitioning BOC or AT&T could use its monopoly power to impede competition in the electronic information services market before granting the requested relief. As I described before, the starting point for this analysis must be the market share of the BOC or AT&T. The FCC should only begin to consider granting any relief when the market share of the petitioning company has dropped below the 75 percent level.

By specifying use of the MFJ criteria, the Congress would give the FCC additional guidance about the kinds of factors that the Congress believes are important in deciding on the appropriate action. The MFJ Court's application of the criteria, and the associated concerns it has discussed, serve as something of a "legislative history" that would be helpful to the FCC in applying the standard. Use of the criteria as a key evaluation factor also would help to ensure that AT&T and the BOCs are not allowed into the electronic information services market when they still are positioned to dominate this critical new medium for dissemination of information to the public.

Closely tied to use of the specific standard enunciated in the MFJ, the Congress also should mandate that the FCC give specific consideration to the Diversity Principle. The best way to do this, as I have suggested before, is to enact a statutory bar on BOC provision of electronic information services and AT&T provision of electronic publishing, to remain in effect until their respective market shares drop below the 75 percent level.

The Congress should be cautious in imposing any time limitations for FCC action on petitions for relief. Rather, the Congress should direct the FCC to allow adequate opportunity for public analysis and comment prior to any FCC determination, to ensure that all issues are fully aired.

In undertaking its analysis, it may be appropriate for the FCC to consult with other independent agencies or executive branches. Clearly, the Department of Justice has substantial expertise that it can bring to bear in analyzing the competitive effects of BOC or AT&T entry into the electronic information services market. In addition, the FCC should consult with the Small Business Administration, which was created in part to carry out the declared statutory policy of the Congress "that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise." As a result of this mission, the Small Business Administration may be able to provide valuable assistance to the FCC in protecting the development of a competitive electronic information services industry.

Finally, the analysis undertaken by the FCC should not vary with the proposed means of market entry. Competitive concerns are presented whether the BOCs and AT&T enter the market through acquisition of another entity or through initiating their own operations.

C. Proposed Areas for Safeguards

I previously described why, in general, the safeguards proposed for competitive BOC ventures are inadequate to prevent domination of electronic information services by the providers of bottleneck transmission services. I should make clear that ANPA believes that, as I discussed previously, safeguards can play an important role once the market share of AT&T and the BOCs drops below 75 percent. However, the safeguards must be carefully crafted to minimize the carriers' ability to manipulate the requirements to their advantage.

Now, I would like to take the opportunity to address specific questions raised in the proposed amendments. The areas in which specific safeguards were suggested fall into four categories: (1) accounting and related safeguards; (2) rules for use and disclosure of network and customer information; (3) nondiscriminatory access and interconnection; and (4) separate subsidiaries.

Accounting and related safeguards would include cost allocation procedures, auditing of telephone company accounting procedures, rules for transfer of assets among affiliates, and outside financing requirements. The FCC currently is in the midst of a contested proceeding seeking to establish requirements in many of these areas. As you might guess, the BOCs prefer accounting methods that afford them maximum discretion in allocating costs between their competitive and monopoly operations. The BOCs' competitors and ratepayers, on the other hand, urged the Commission to adopt clear rules to ensure that BOC competitive ventures bear their full share of costs. What the Commission will do remains to be seen, but its past actions afford little assurance that it will impose meaningful rules on the BOCs.

To help ensure that the FCC adopts minimally acceptable accounting procedures, the Congress should require that the cost allocation rules minimize carriers' discretion by requiring maximum assignment of direct costs and apportioning common costs on the basis of actual relative use. The cost allocation rules also should include service definition guidelines to ensure that costing is not based on strategic considerations. Finally, several enforcement mechanisms, including the establishment of a cost allocation task force within the FCC, stand-alone cost tests, and annual audits by independent accounting firms, are necessary.

The rules for treatment of both network and customer information similarly have not been finally established by the FCC. The rules for the BOCs are still being addressed in Phase 2 of the FCC's Third Computer Inquiry. The rules applied to AT&T for its use of customer information are of questionable value. At present, the burden for informing AT&T personnel that a customer does not want information about its network usage supplied to enhanced services personnel rests squarely on the customer. Thus, if AT&T customers, who may be competing electronic information service providers or customers of those competing operations, do not act quickly enough, their network usage information may be used by the AT&T enhanced services personnel anticompetitively to target marketing.

Clearly, the Congress should make sure that the FCC rules require that information about network changes be disclosed at the earliest possible date so that BOC and AT&T affiliates do not gain an unfair headstart based on tailoring of their services to the network changes. Customer information must be accorded proper confidential treatment to ensure that this "inside" information cannot be used to the detriment of competitors.

As I've noted, imposing a nondiscriminatory technical access and interconnection requirement is not adequate by itself to prevent discriminatory behavior on the part of the BOCs and AT&T against their electronic information services competitors. Moreover, the FCC has failed to impose a true nondiscriminatory interconnection requirement. Rather, its comparably efficient interconnection and open network architecture standard would allow the BOCs and AT&T to provide inferior interconnection to competitors if they can identify some justification. In addition, I want to point out that AT&T has requested that the FCC reconsider and not impose the CEI and ONA requirements on AT&T.

Experience has shown that even structural separations do not prevent anticompetitive and discriminatory behavior on the part of the BOCs. For example, the California PUC has identified numerous cases where Pacific Bell ratepayers have subsidized the competitive activities of Pacific Telesis and where the competitive affiliates have received favored treatment. While separate subsidiaries can permit public detection of some improper activities, subtle forms of cross-subsidization and discrimination remain possible.

It is important to bear in mind that these same BOCs once were part of the AT&T corporate organization that required restructuring in order to restrain its anticompetitive activities. The BOCs retain the same opportunities and incentives to act anticompetitively. Because these companies have the AT&T history in their corporate background, the discrimination may be conscious or subconscious, overt or covert, or simply based on their monopoly control of the transmission networks.

ANPA has concerns about these safeguards because of the nature of the electronic information services business. In general, customers need timely delivery of error-free information. The providers of the monopoly transmission facilities have many opportunities to delay information delivery by competitors or to degrade the transmission quality. If these same monopoly providers can enter the electronic information services marketplace, they will have every incentive to exploit these opportunities. This situation thus reiterates the need for a clear statutory bar.

D. State Regulatory Jurisdiction

The Congress should make clear that regulatory commissions may not circumvent the Diversity Principle. The states have an important role to play in a number of areas, including the protection of ratepayers, that can in fact facilitate implementation of the Diversity Principle. The states may be positioned to bolster the requirements that are designed to ensure that electronic information services competitors are not discriminated against by the BOCs and AT&T. At the same time, however, the Congress should make clear that the states may not hamper fulfillment of the First Amendment policies embodied in the Diversity Principle.

E. Antitrust Enforcement

The Department of Justice should retain independent jurisdiction to prevent anticompetitive abuses by AT&T and the BOCs. As currently written, S. 2565 permits an interpretation that it is providing antitrust immunity to AT&T and the BOCs for a range of activities. I do not believe that was the intent, and I urge the Congress to clarify the language.

To sum up, ANPA urges the Congress to leave to free competition, among a growing list of new entrants, the development of electronic information services provided over telephone facilities by enacting into law the Diversity Principle.

The following information was subsequently received for the record:

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. Doesn't the information services restriction mean that consumers are being deprived of services that would otherwise be available?

Answer. Far from depriving consumers, the information services restriction has created a flourishing competitive marketplace in which thousands of services and products are available and many new ones are introduced daily.

A host of companies, large and small, today provide a wide range of information services. It is unlikely that these companies would have risked capital to offer services that require the use of the telephone network if they were faced with competition from the monopoly owner of the telephone lines. Indeed, some of the smaller companies might not even have been able to secure the necessary capital in the face of competition from the providers of a critical element of these services. Thus, the restrictions in the MFJ are pro-consumer and pro-diversity.

It appears that the BOCs have deliberately postponed offering interconnection and network enhancements needed by information service providers; they certainly would have the incentive to do so. A prime example of this reluctance has been the failure of the BOCs to provide the interconnections necessary to allow the development of Custom Calling II-type services. The BOCs may hope to be freed from the terms of the MFJ, and would prefer that others not become established in telephone-based information service businesses until the BOCs themselves can provide such services.

In order to remove these anti-consumer incentives, the BOCs should receive a clear message from Congress that the information services restriction will not be removed as long as the BOCs control a bottleneck monopoly over local exchange service.

Question. What information services are the newspapers providing now?

Answer. As indicated in the testimony of Uzal H. Martz, Jr. before the Committee on September 16, 1986, and as illustrated in the article from the August 25, 1986 issue of *Business Week* which was attached thereto, the ranks of information providers are not limited to newspapers. Over 1,400 firms are involved in publishing electronic information. That number includes not only newspapers, but also many other companies, both large and small. Illustrative information services currently being provided by newspapers include:

The Fort Worth Star-Telegram offers a videotex service called Startext, which provides updated news, closing stock prices, electronic mail and classified ads to personal computer users in the Dallas/Fort Worth area.

The Spokane Spokesman-Review and the Advertiser-Tribune in Tiffin, Ohio, similarly operate electronic information services which personal computer users in their markets can access via the local telephone network.

The San Francisco Chronicle, the Louisville Courier, and the Tribune Company are developing public access services in the form of kiosks located in shopping malls, hotels, airports, and other public locations to provide a guide to local restaurants, theatres, transportation services and local events. Most of these services utilize transmission facilities provided by the local telephone companies.

The New York Times plans to offer Pulse, a guide to services and events in the New York area, as part of the Covidea service. Covidea ia sjoint venture among AT&T, Time, Inc., Chemical Bank and Bank of America, intended to offer financial information and tranactional services aimed at individual stock brokers.

Some 200 newspapers have affiliated with Knight-Ridder's Vu-Text or DataTimes, an Oklahoma publishing subsidiary, to automate their libraries, and these same databases are also offered commercially.

The Dow Jones News/Retrieval service offers up-to-the-minute financial news and information as well as transactional services such as electronic shopping to more than 200,000 subscribers with personal computers. Dow Jones also offers Dow Phone, an interactive voice response system that allows subscribers to request specific stock quotes and news on 6,500 publicly traded companies by using a touch tone phone keypad. The information is provided in voice form.

The Oakland Press, in Pontiac, Michigan, offers StockQuote Hotline. Using a touch tone telephone, subscribers can obtain stock quotes for over 8,000 listings from a talking computer.

Lee Enterprises also is developing telephone-based information services.

Gannett, Inc. provides USA Today Update, an information service aimed at specialized industries such as banking, telecommunications, law and technology through the Source and other system operators.

This listing is by no means comprehensive. Rather, it is intended to provide an indication of the range of activities and research being undertaken by newspapers in the electronic information services field. In turn, the activities being pursued by newspapers represent only a portion of the electronic information services marketplace.

Question. Some have argued that the concerns of the newspapers are not really the First Amendment and the Diversity Principle, but rather the revenues that would be lost if the telephone companies were able to provide classified ads that were updated daily. What is your response to that argument?

Answer. ANPA does not necessarily object to the telephone companies providing advertisements; for instance, it has not opposed the efforts by Southwestern Bell Corporation to provide Yellow Pages outside of its region nor has it opposed other print media activities by the BOCs. ANPA's fundamental concern is with the dangers inherent in the situation where control of the information being provided to the public is combined with control of the transmission facilities over which the information flows. That concern would not be raised were a BOC to provide daily updated Yellow Pages over a telecommunications system not within its control, such as cable television lines.

For example, it would be consistent with the Diversity Principles for Bell Atlantic to provide Yellow Pages in its region through cable television wires and Southwestern Bell to provide competing Yellow Pages in the same region over Bell Atlantic's telephone lines.

As structured, the question miscontrues ANPA's position. It is not the provision of electronic information service per se that is of concern; rather, it is the control of both the information and the monopoly transmission facilities that poses the risks to diversity and full competitive development of the electronic information services marketplace.

Question. Does the FCC have adequate jurisdiction over the RBOCs to develop accounting safeguards to prevent cross-subsidization between regulated and new unregulated ventures? In other words, can the FCC oversee potential cross-subsidy between local or intrastate services and new businesses?

Answer. This question begs the fundamental issue of whether accounting safeguards can, in fact, prevent cross-subsidization between regulated and new unregulated ventures. Although the issue of FCC jurisdiction over intrastate offerings remains a matter of some controversy at the FCC and will likely not be fully resolved until judicial review of the Computer III decision is completed, the evidence has been steadily mounting that accounting safeguards cannot themselves prevent ratepayers from subsidizing competitive ventures. Both the courts and the FCC have recognized that even structural separation does not change telephone company incentives to cross-subsidize, or destroy their ability to do so. Rather, it can, at most, make instances of cross-subsidization more easily discoverable. Moreover, only three years ago the FCC acknowledged that accounting rules were even less effective than separate subsidiaries and are unlikely to have more than a precatory effect in restraining anticompetitive behavior. See BOC Structural Separation Order, 95 F.C.C. 2d 1117, 1130-31 (1983).

As stated in the testimony of Uzal H. Martz, Jr., before this Committee on September 16, 1986, accounting safeguards "can be manipulated and even abused to enable the BOCs and AT&T to favor improperly their own information services operations to the detriment of competitors and at the expense of the public. Accounting requirements are highly susceptible to manipulation. The telephone companies, for example, can engage in strategic costing to produce the desired result. Decisions about allocations of joint and common costs also create opportunities for cross-subsidization. Accounting requirements fail to prevent cross-subsidization because the overall accounting system is within the control of the BOC." Testimony at 14. For these reasons, ANPA continues to support the Diversity Principle, which would prohibit the combination of control of both the content of electronic publishing services and the transmission facilities used to deliver them.

These problems with reliance on accounting procedures while the BOCs and AT&T retain effective monopolies reemphasize the need for enactment of the Diversity Principle into law. ANPA does not seek to exclude the BOCs from the electronic information services market should they lose their monopoly domination of local exchange services. Rather, relief from the statutory bar should be made available when a BOC has less than a 75 percent customer-based market share for local telephone service. Entry into electronic information services would then be conditioned on clearly defined protective safeguards.

Question. Specifically, what control over local exchange, intrastate long distance, Yellow Pages, information services or manufacturing does the FCC have now and what control should they be given?

Answer. ANPA does not believe that FCC regulation can serve as an effective substitute for a statutory enactment of the Diversity Principle.

The current FCC rules are not sufficient to prevent anticompetitive discrimination by the BOCs against information services competitors or cross-subsidization of their own competitive service offerings with ratepayer revenues. Judge Greene recognized that the Department of Justice found it necessary to bring its antitrust suit against AT&T because of the failure of the FCC adequately to regulate AT&T and to prevent anticompetitive abuses. The FCC currently is reviewing certain of its rules in the Computer III and cost accounting proceedings, but, based on past experience, ANPA is not alone in questioning whether rules even minimally adequate will be adopted.

Finally, numerous statements have been made by members and staff of the FCC that suggest that the FCC has prejudged the issue of eliminating the line of business restrictions for BOCs. These statements imply that the agency will not exercise whatever authority it may have to preserve diversity in electronic information services. For example, as pointed out in the September 16, 1986 testimony on behalf of ANPA, FCC Chairman Fowler has described the MFJ line of business restrictions as a "huge roadblock" which must be removed. Commissioner Patrick also has made clear his view that the information services restriction prevents the realization of the full potential of Computer III.

Question. Is it possible to require the states to develop regulatory mechanisms to protect ratepayers in view of the lack of jurisdiction the FCC has in these areas? How?

Answer. State regulatory agencies are charged with their own missions to protect the ratepayers of the telephone companies subject to their jurisdiction. However, even the states have recognized the limits on their ability effectively to protect ratepayers. In a letter to Peter Huber dated August 12, 1986, commissioners with public service commissions in nine state concurred in the statement that, at present, "regulators can neither prevent nor measure the extent of the BOC's ability to impede competition by subsidizing its own production in competitive ventures using assets or revenues from its rate-regulated operations. Recognizing this fact, it would be false to assume that the lifting of MFJ restrictions can proceed with confidence that state regulators have the ability to effectively control cross-subsidies." The best means for the Congress to ensure that ratepayers are adequately and consistently protected from BOC abuse of their monopoly positions with respect to information services is to enact the protections of the Diversity Principle into law.

Question. What guarantees do ratepayers have that they will not be funding all kinds of high technology equipment in the local telephone network information services that they don't need or want?

Answer. As set out in ANPA's response to Question No. 4, the simple answer to this question is NONE. Even under the comparatively strict Computer II regime, which required separate subsidiaries for the provision of competitive services, recent audits by state public utility commissions have found rampant cross-subsidization as well as non-cooperation by carriers with regulatory bodies attempting to discharge their statutory responsibilities. For example, the California PUC identified some $17,000,000 in cross-subsidies between Pacific Bell's regulated and unregulated operations. Moreover, state audits of Bell Atlantic, BellSouth, PacTel, and U S West revealed refusals to disclose necessary data. Trade press reports of a National Association of Regulatory Utility Commissioners' publication revealed that all four carriers denied auditors "'access to materials pertinent to their studies.'" NARUC also reported state PSC findings of "poor accounting records, duplication of services, diversion of future funds, deficient transaction standards, and passing on of lobbying costs to subsidiary operating companies." Telecommunications Reports, July 21, 1986, at 8.

Moreover, ANPA explained in it comments in the FCC's investigation into accounting procedures that the BOCs are attempting to validate such obstructionist practices on the federal level as well by supporting accounting systems that would permit allocation of joint and common costs on a discretionary, unauditable incremental costing basis, exempt large amounts of costs from any allocation procedures, and shield from the FCC and interested parties data necessary to effective audit oversight. Accordingly, ANPA seriously doubts that accounting safeguards can protect ratepayers from subsidizing competitive electronic information services ventures.

Question. A lot of services could fall under the definition of information services or electronic publishing as ANPA sometimes defines it—services like telephone call forwarding and voice store-and-forward services. Do the newspaper publishers expect consumers to go without these and potential similar services, or are the newspapers proposing that they provide such services themselves on a scale comparable to what the telephone companies can provide?

Answer. The Diversity Principle will not prevent telephone companies from providing state-of-the-art telecommunications services, but will encourage it.

First, it may be necessary to clarify several misconceptions, implicit in this question, about the information services industry and the scope of the line of business restrictions in the MFJ.

Newspapers represent an important but modest segment of the non-telephone company information services industry. Many other companies with substantial technical resources and experience, such as IBM, General Electric, and General Motors, can be expected to provide consumers with information products and services for which there is demand.

Moreover, telephone companies are not constrained by the MFG, nor would they be by the statutory enactment of the MFJ's line-of-business restrictions, from providing new exchange telecommunications services. Indeed, the telephone companies have long offered call forwarding, and ANPA has never questioned this.

It should also be noted that ANPA does not advocate some definition of its own for "information services" or "electronic publishing." These terms reflect concepts embraced by the Senate in S. 898 in 1981 and are defined in the MFJ. ANPA urges Congress to use the same definitions in any statute.

Finally, ANPA believes that the services subsumed under the MFJ's electronic publishing definition are most important to the Diversity Principle. There is a broad range of other services, such as those engaged in by AT&T under the MFJ, which may fall within the information services rubric but which do not involve any telephone company interest in information content. Thus, the BOCs could offer services such as packet-switched networks, protocol conversion, data processing, and voice or data store-and-forward. Some of these services, such as store-and-forward, could be operated in such a way as to convert them into a publishing activity if they were used by the carrier to control, profit from, or have any interest in the information carried over its transmission facilities. But the current administration of the MFJ, which allows AT&T to provide information services as long as they are not electronic publishing, demonstrates that a line can be drawn which protects the core of the Diversity Principle while allowing a carrier to participate in many information-related consumer services.

Question. The French have recently concluded experiments on videotext service that includes an "electronic Yellow Pages" and are taking the service nationwide. The experience in France seems to be that using the telephone network as a transmission vehicle has stimulated newspaper advertising revenues. Don't you think a similar result would occur in this country?

Answer. The question of newspaper advertising revenue has absolutely nothing to do with the Diversity Principle or with proper public policy concerning telephone company involvement in providing electronic information services. The issue is *not* newspaper profitability, but the right of the public to have access to a wide diversity of sources of information. And, needless to say, the relevance of the French experience is tangential, given that country's very different social, political, economic and information system.

The French government-owned telephone system has been experimenting with new services for a number of years. Some French newspapers in France have participated in those services.

It is far too early to tell how successful such operations will turn out to be. To draw any conclusions at this time would be premature.

Lest it go unsaid, newspapers and others with an interest in the Diversity Principle are not seeking to prevent the development of these services; these information publishers seek only open access to a level playing field that is not owned and controlled by one of their competitors in this new market.

The Diversity Principle serves the best interests of competition and diversity in any language.

The CHAIRMAN. Thank you, Mr. Martz.

Mr. Kimmelman?

Mr. KIMMELMAN. Thank you, Mr. Chairman.

I appreciate this opportunity to appear before you today on behalf of the Consumer Federation of America. It is refreshing to come before the Committee on an issue different than the many we have had to address in the last year, and it is particularly refreshing to come endorsing the effort that you are making, Mr. Chairman, to make sure that affordable phone service is the cornerstone of Federal telecommunications policy.

I would like to start by pointing out that from the consumers perspective we have no philosophical opposition or concerns about local phone companies getting into any businesses, or any other businesses getting into other businesses, and we have no inherent preference for the courts over Federal agencies or Federal agencies over the courts. That does not really matter as much to consumers right now as rebuilding faith in our telephone system after the breakup of AT&T.

We believe that the public wants assurances that whatever we are doing with our phone system, whatever policies we change, that elected officials ensure that we do not give away any of the best attributes of the old phone system: affordable, reasonably priced, high-quality phone service for all Americans whether in rural or urban areas, wealthy or poor.

Therefore, CFA must oppose S. 2565 precisely because it does not set policy. It does not address consumer concerns. Mr. Chairman, we are very encouraged by your proposed amendments. We believe that making a Federal commitment to affordable basic phone service, including usage of the telephone, is essential to the consideration of any restructuring of our telephone system. We urge you to continue to try to figure out the details of how to accomplish this through the legislative process.

Now, some have asked why we are so worried about lifting restrictions at this point on the Bell Phone Companies, and why we are so worried about handing jurisdiction over to the FCC. Well, the answer is very simple. Look at the promises of those who are proposing these changes. They promise new services. They promise the information age. They promise a restructuring of our society through the telephone system.

Now when have we heard this before? It was not very long ago that we heard these very same promises related to the AT&T divestiture and related to the Federal Communications Commission's repricing practices.

A brief review of what consumers have experienced in the last years will explain why we are concerned that the costs of these changes may be greater than the benefits. First of all, since divestiture the local phone companies have asked for $11.3 billion in new revenue and received $5.2 billion in the States.

The FCC has proposed a subscriber line charge that now has shifted over $2 billion from long distance rates into local charges, and they are considering moving that up to $4 a month. It is now at $2 a month. On average we find that with these subscriber line charges and local rate increases consumers are paying about 45 percent more for local charges today than they were at the time of divestiture. And then of course they have to buy or rent a phone, pay for repair, pay for directory assistance, and pay more for installation charges.

In addition, we have found in a recent report that we just completed which I would like to submit for the record,[1] Mr. Chairman, that in 1985 the local phone companies were earning approximately $3 billion too much from both residential and business ratepayers, money that was not necessary for a thriving business, money that was much greater than the earnings of both competitive companies and other utilities.

It is clear these companies are sitting on a lot of money. It is no surprise that they are eager to diversify.

Now the phone companies claim that local service is still way underpriced, and they claim they have a depreciation reserve deficiency for equipment no longer being used that is on the books that carries a price tag of $26 billion to consumers. We have also seen that our traditional progress toward universal service, going from 78 percent of households with a phone in 1960 to 92.9 percent in 1980 has been stagnating, at best, and creating tremendous pocketbook pressure for fixed-income/low-income elderly Americans.

So our question is, why? Why all this? Do we have to give up affordable phone service? Can we not preserve what we have accomplished in the past and still move on to the information age?

We believe it is possible to preserve the good aspects of our phone system and achieve the benefits of a new information age, but this can only be accomplished if Congress will set clear policy goals and prevent industry and FCC efforts to load additional costs onto those who just want simple, plain old phone service.

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[1] The report was not reproducible.

We believe Congress must begin a careful examination of how to change the rules of the phone system while also protecting ratepayers. Policymaker intervention is essential when so much of the network costs involve jointly used resources. It is the difference between preserving rates at their current level and a doubling or tripling of rates with inappropriate policies.

In conclusion, Mr. Chairman, we urge you to move slowly in building on your amendments, to set forth the details of regulatory action that is needed to both preserve the goal of universal affordable phone service for all citizens and fair rules that open the door to competition in computer services and other markets.

We believe American consumers deserve more than just lofty promises about the information age. From Congress, American consumers deserve clear assurances that we will not get in another mess like the AT&T breakup; Congress must ensure a framework for modern communications, the basic phone network, that will be accessible to all at affordable rates as we move forward into the information age.

Thank you.

[The statement follows:]

STATEMENT OF GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

The Consumer Federation of America (CFA) believes that ratepayers' pocketbooks must be protected and the benefits of competition made available to all consumers before the Bell Operating Companies (BOCs) are released from the restrictions they voluntarily agreed to as part of the Bell system breakup. Consumers have already been asked to bear more than their fair share of post-divestiture risks. Any further telecommunications policy changes must, first and foremost, promote attainment of affordable phone service for all Americans.

From the consumer prespective, the debate over whether or not to lift restrictions placed on the BOCs in the Modified Final Judgement (MFJ) is reminiscent of the debate over breaking up the Bell system. Consumers are being showered with promises of information age services, increased competition, lower telephone rates and new uses of the telephone by those seeking to change the status quo.

Unfortunately, consumer experience with the Bell breakup leads to skepticism about such promises and a concern that the backbone of our telephone system—high quality, affordable basic phone service available to all Americans—may be jeopardized by experimentation with new policies and promotion of exotic services. Stung by significant local rate increases, a $2/month federal subscriber line charge and considerable confusion since the American Telephone and Telegraph (AT&T) divestiture, consumers expect concrete assurances rather than lofty promises from those who wish to change the rules of the telephone game one more time.

I. BACKGROUND

As telecommunications technology changes and public reliance on the telephone increases, consumers face new challenges to their desire to preserve affordable phone service. After almost twenty years of watching the federal and state governments struggle to protect affordable service while increasing competition, consumers remain unconvinced that policymakers know how to open the door to the information age without shutting the door on cheap, high quality basic phone service.

A. Technology and Regulation

Policymakers have fought an uphill battle, using everything from rate-of-return regulation to divestiture, in an effort to keep the price of monopoly services—like local residential service—down while opening the equipment, long distance and computer markets to full, fair competition. Unfortunately, the tools of public policy have not developed at the same pace as technology.

Technology has eroded many of the conceptual distinctions essential to effective regulation. For example, regulatory policies bases on a clear distinction between communications and computer technologies became ineffective as telephone companies began using computerized equipment. Similarly, technical changes in equipment and service have outpaced accounting definitions and categories, making it impossible for the Federal Communications Commission (FCC) to establish a uniform accounting system that properly allocates costs.

B. Market Segmentation/Competition

These regulatory difficulties have been exacerbated by the uneven development of competition in niche markets surrounding the local network monopoly. Since the network of lines and switches connects both monopoly (e.g., local residential service) and competitive (e.g., long distance and data processing) services, regulators must divide network costs among these services. As competition develops for a particular product, like telephones, or service need, like big-business data communications, regulators must restructure prices. Yet without effective accounting tools or a head-start on technology, it is difficult, if not impossible, for regulators to divide the $30-40 billion of today's shared network costs without impeding competition or driving up basic service prices.

C. Dangers of Lifting Bell Operating Company Restrictions

Because a misallocation of network costs can mean the difference between affordable local phone service and doubling or tripling local rates, CFA is fearful, under current regulatory conditions, of letting the companies that control the local network—the BOC's—enter competitive markets. Until policymakers develop the regulatory tools necessary to catch up with technology, and properly allocate the cost of jointly used equipment and resources, consumers have more to lose than gain from local phone company diversification into competitive markets.

II. RATE RESTRUCTURING: A LOSS FOR CONSUMERS

Two and a half years after the AT&T breakup, consumers continue to pay more and get less for their phone-service dollar. Between January 1984 and June 1986, local telephone companies asked for 11.3 billion and received $5.2 billion in revenue increases from state regulators.[1]

During the same time period, the FCC decided to transform $2 billion of long distance charges into local rates increase.[2] Starting in June 1985, all residential consumers, regardless of whether they make any long distance calls, began paying a $1/month "subscriber line charge" for equipment costs formerly charged to interstate long distance users. In June of 1986, this charge rose to $2/month. The Commission is currently considering a local phone company proposal to raise this charge to $3/month in 1987 and $4/month in 1988.[3]

A. Local Charges

These new local charges translate into an average increase in residential flat rate (unlimited local calling) service of $4.74/month since the Bell breakup. This 45 percent increase consists of the following elements: an increase in flat rate service from $10.55/month at the end of 1983 to $12.73/month at the end of 1985; a $2/month subscriber line charge imposed by the FCC in June, 1986 that appears on each customer's local phone bill; plus $.56/month to maintain telephone wiring (this wire maintenance charge, though optional, used to be included in pre-divestiture local service charges).[4] So, today, it costs consumers $15.29/month to receive what cost only $10.55/month two and a half years ago. In addition, consumers must now pay for local directory assistance calls, purchase or pay $1.50/month to rent a phone, plus pay considerably more for installation—27 percent more in 1984 alone.[5]

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[1] Industry, Analysis Division, FCC, Trends in Telephone Service, July 22, 1986, at 5.

[2] In the Matter of MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rates and Establishment of a Joint Board, cc Docket Nos. 78-72 and 80-286, adopted Dec. 19, 1984, released Dec. 29, 1984.

[3] "Unity 1-A Agreement," See Joint Comments of the National Rural Telecommunications Association, National Telephone Cooperative Association, Organization for the Protection and Advancement of Small Telephone Companies and United States Telephone Association, In the Matter of MTS and WATS Market Structure, cc Docket Nos. 78-72 and 80-286, August 29, 1986.

[4] Divestiture: Two Years Later, A Report on the Status of Residential Telephone Consumers Two Years After the Breakup of AT&T, Consumer Federation of America, December 18, 1985; and In the Matter of MTS and WATS . . . op. cit.

[5] Id., at 3.

B. Long Distance Rates

In return for these significant post-divestiture local rate hikes, consumers have received a modest decrease in long distance rates. Since May 1984, when the FCC's subscriber line charge went into effect for business customers, and June 1985, when the subscriber line charge went into effect for residential customers, AT&T was ordered to reduce is long distance rates 16.7 percent for night and weekend calls, and 25.5 percent for the more expensive day and evening calls.[6] Unfortunately, for the large percentage of consumers who make few long distance calls each month, these long distance rate reductions do not even come close to offsetting post-divestiture local rate increases.

III. THE DOLE BILL

If Congress intends to get involved in contentious, telecommunications industry issues—whether procedural, jurisdictional or substantive in nature—we believe it is essential that Congress let the American people know what policies it intends to further through its legislative actions. Unfortunately, S. 2565, the "Federal Telecommunications Policy Act of 1986," sponsored by Senator Robert Dole (R-Ks) fails to address any of the nation's most important telephone policy issues. In shifting oversight of the AT&T and GTE consent decrees from federal court to the FCC, S. 2565 would provide consumers no protection against continued local rate increases.

By relying on current FCC regulatory policies to protect ratepayers and competition, S. 2565 could jeopardize the affordability of basic phone services and the potential consumer benefits of competition. As stated above, the FCC's repricing policies have already shifting about $2 billion of long distance costs into local rates and the Commission is currently considering another $2 billion shift (see supra. at 4). In addition, a brief description of the FCC's newly developed approach to regulating competitive services connected to the network will highlight the problems inherent in S. 2565.

A. Computer III

The FCC's Third Computer Inquiry (Computer III)[7] deals with the appropriate regulation of what is known as "enhanced services," those services which:

> combine [s] basic service with computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information, or provide the subscriber additional, different, or restricted information, or involve subscriber interaction with stored information.[8]

In the divestiture proceeding, Judge Greene noted that enhanced services are essentially the equivalent of "information services."[9] Besides electronic publishing, enhanced services consist of three types of services: voice storage; protocols-type processing—that is, enhancement or alteration of a data transmission that is not compatable with the receiving data processing equipment or data network; and network data processing—the use of the switched communications network as a giant computer accessible through terminals or computers plugged into it. These services thus use the same trunks, switches, central offices, and subscriber loops as basic phone service.

Previously, under its Computer II rules, the FCC required dominant (i.e. monopoly) carriers like AT&T and the BOC's to separate all enhanced (i.e. competitive) services from their regulated network services through a subsidiary. Yet in its recent Computer III ruling, the Commission indicated a shift in policy.

Although the Commission concluded in its Computer II decision that accounting procedures ". . . cannot prevent the misallocation of joint and common costs associated with the provision of basic and enhanced services if provided by the same entity,"[10] in Computer III the FCC has decided to rely on a cost allocation accounting system, equal access requirements (comparably efficient interconnection) and a new network structure (open network architecture) to prevent cross-subsidization. Unfortunately, none of these new safeguards against cross-subsidy currently exists, the technology necessary to implement such protections has not been developed, and the cost of this system is unknown. Furthermore, the FCC's ongoing search for a cost allocation accounting system does not include reconsideration of the Commission's previous decisions to shift a predominant portion of joint and common network costs into basic local rates.[11]

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[6] Industry Analysis Division, FCC, op. cit., at 6.

[7] Notice of Proposed Rulemaking, cc Docket No. 85-229, released August 16, 1985.

[8] Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 77 FCC 2d 384 (1979) (Final Decision), aff'd on reconsideration, 84 FCC 2d 50 (1980), 88 FCC 2d 572 (1981) aff'd sub nom., *Louisiana PSC* v. *United States*, 461 U.S. 938 (1983).

[9] *U.S.* v. *AT&T*, 552 F. Supp. 131, 178 n. 198 (D.D.C. 1982).

[10] Amendment of Section 64.702, op. cit., 77 FCC 2d 384 at 464.

Unfortunately, accounting and equipment interconnection requirements can neither ensure affordably priced basic phone service nor protect a fair competitive environment.

1. Accounting Problems

No accounting system has yet been devised that can adequately detect misallocation of the costs of jointly used equipment and resources. Although the FCC has not developed a set of accounting procedures to handle this problem, and has historically been criticized for failure to develop adequate accounting standards,[12] the Commission presumes that an accounting-fix is just around the corner.

Given the pricing incentives of companies that provide both monopoly and competitive services, CFA believes ratepayers would be endangered if the BOC's are allowed to enter competitive markets under the FCC's accounting, rather than separate subsidiary requirement. New technologies have transformed a unified, telecommunications market into a segmented mixture of monopoly and competitive submarkets. The partial competition of a segmented telecommunications market distributes benefits to large volume, long distance/computer customers (i.e., big businesses), and loads costs on everyone else (i.e. residential and small business customers). Telephone companies that serve both competitive and monopolistic markets have an incentive to maximize profits by shifting costs from the most to the least competitive services. To prevent such cost shifting, the FCC proposes a cost allocation accounting approach previously described by the Justice Department as "presently but a hope, not a demonstrated reality."[13] Based on market pressures to shift costs and the General Accounting Office's criticism of the FCC's failed 20 year effort to account for costs,[14] we believe that the Justice Department's previous assessment of the dangers created by allowing monopoly service providers into competitive markets remains accurate:

> Based on the information presently available to it, the Department does not believe that either structural separation or the use of accounting principles is itself a sufficient answer to the problem posed when regulated firms controlling bottleneck facilities enter related competitive markets. It may be that neither of these regulatory tools is effective in all cases. In some cases, the cost-benefit calculus may favor one form of restriction for all of the myriad types of services that will be offered under a variety of technologies.[15]

2. Intagible Subsidies

Even if the FCC could devise the best imaginable accounting system, some subsidies that utility companies can supply to competitive ventures are so intangible as to defy quantification. These intangible subsidies come in a variety of forms. For example, the name reputation of the companies which comprised the former Bell system is a valuable asset for a competitive service, as is the attractiveness to potential customers of one-stop shopping for information services at the same company which supplies basic, dial-tone service. Unfortunately, accountants cannot objectively assess the value of these shared resources.

Many other activities that a diversified Bell operating company may engage in would involve similar cost allocation difficulties that accounting systems cannot overcome. For example, it is impossible to allocate costs where: experienced utility personnel staff new competitive services; the cost of capital for competitive ventures declines because of the financial stability of the local phone company; competitive services benefit from access to customer information from the BOCs' substantial sales base; or ratepayers bear increased costs because overall corporate investment is riskier when competitive services are added to the network. CFA believes these intangible subsidies can only be dealt with through non-accounting methods.

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[11] In the Matters of: Amendment of Sections 64.702 (Third Computer Inquiry), and Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorization thereof Communications Protocols under Section 64.702 of the Commissions Rules and Regulations; cc Docket No. 85-229, adopted May 15, 1986, released June 16, 1986.

[12] Legislative and Regulatory Actions Needed to Deal With a Changing Domestic Telecommunications Industry, United States General Accounting Office, CED-81-136, September 24, 1981.

[13] Comments of the U.S. Department of Justice, in Notice, op. cit., at 42.

[14] Legislative and Regulatory Actions, op. cit.

[15] Comments of the U.S. Department of Justice, op. cit., at 42.

B. Joint and Common Cost Allocation

S. 2565 fails to address the major pocketbook issue facing consumers in the post-divestiture era: who will pay for the astronomical cost of network equipment and resources used jointly to provide many services? Unless legislation like S. 2565 overrides the FCC's cost-shifting access charge price theory, consumers will end up paying for anywhere from $6-12 billion in network costs through local rate increases (i.e., interstate and intrastate subscriber line or other charges), regardless of how much money the BOCs make from new services.

There is no "correct" way to allocate the cost of jointly used equipment and resources. While one approach may provide maximum economic efficiency and another maximum social fairness, many cost allocation methodologies can meet the Communications Act's combined goals of affordable phone service and fair competitive conditions. As pointed out in recent appellate court review of FCC policies:

> The very problem at issue here—allocation of common costs—arises precisely because there is no purely economic method of allocation . . . elements of fairness and other noneconomic values inevitably enter the analysis of the choice to be made.[16]

Industry cost allocation proposals, which in the access charge decision were accepted by the FCC, would lead significant local rate increases. Whenever costs do not vary with usage, as is the case for most joint and common network costs, most Bell companies have recommended exempting new competitive services from sharing these costs. As Bell Atlantic stated in its Computer III filing, "any reasonable firm . . . does not allocated any portion of it joint and common costs which do not in fact vary as a direct result of offering the new service."[17] Southwestern Bell, U.S. West and Ameritech expressed similar views in their comments.[18] So, most of the Bell companies seek to benefit ratepayers by adding new services to the telephone network that will not pick up any of the $6.5 billion worth of non-usage sensitive network costs under FCC jurisdiction, or the $5 billion worth of similar costs under state jurisdiction.[19] Unless Congress requires the FCC to reverse its pricing policies—a policy reversal not mandated by S. 2565, the Commission's Computer III transmission tariff procedures are unlikely to distribute any fixed network costs among information services.

IV. THE DANFORTH AMENDMENTS

Senator John Danforth's (R-MO) proposed amendments to S. 2565 represent a good starting point for building consumer protections into legislation that affects the MFJ. Yet since we believe the FCC's pricing policies endanger achievement of Senator Danforth's goal of "universal, affordable local telephone access and usage," CFA cannot support legislation that fails to set minimum cost allocation guidelines for the Commission to implement.

CFA believes that Congress should not lift the MFJ restrictions placed on the Bell companies by Fedral District Court Judge Harold Greene until regulations are in place that would equitably allocate the cost of all jointly used equipment and resources, and prevent price or network-access discrimination among service providers. By conditioning Bell operating company entry into the information services market on the development of regulatory safeguards, specified in legislation, like Representative Ron Wyden (D-OR) has proposed,[20] competition may be preserved and consumers protected from local rate increases.

A. Cost Allocation

If the FCC applies the same pricing theory for information services and equipment manufacturing in Computer III as it did for long distance service in the access charge proceeding, all the fixed costs of jointly used equipment and resources will be allocated to basic, local phone service. To ensure that non-basic service users do not get a free ride on the backs of local service users, Congress should require that the cost of equipment used to provide local, long distance and computer services is equitably distributed among those services. If each service covers the costs that are unique to it, plus a reasonable portion of the cost of equipment used jointly for numerous services, local phone rates would remain reasonable while all other services could be competitively priced. Congress must step in to ensure that everyone who uses services connected to the telephone network pays to maintain the network.

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[16] *MCI Telecommunications Corp.* v. *FCC*, 675 F.2d 408 at 415-416 (D.C. Cir. 1982).

[17] Comments of Bell Atlantic Companies in Notice, op. cit., at 10.

[18] Comments of Southwestern Bell Corp. in Notice, op. cit., at 49-53; Comments of U.S. West, Inc. at 106-107; Comments of Ameritech at 35-41. But See Comments of Pacific Telesis Group, Attachment A, at 3 for a more reasonable cost allocation methodology.

[19] Report of the Committee on Energy and Commerce on H.R. 4102, 98th Congress, First Session, Report No. 98-479 at 19-24.

[20] Congressional Record, Vol. 132, No. 114, August 15, 1986 at H6428-H6432.

B. Competition

It would be inappropriate to assume that just because the telephone industry and regulators are beginning to talk about "open network architecture" and "comparably efficient interconnection" that a technical fix to ensure fair, equal access to local phone company facilities can be devised. Similarly, the accounting problems that regulators have spent years attempting to overcome cannot be wished away. Unless all these problems are overcome, Congress must provide that a surrogate for adequate regulatory controls—possibly a royalty charge based on a local phone company's non-basic service revenues—is applied to local phone companies that enter competitive markets. In addition, since many Bell companies are diversifying their business through affiliates of parent holding companies that cannot be regulated by the states, Congress must ensure that state regulators may review the underlying costs of all transactions between the BOCs and their affiliates.

C. Effective Regulation

Despite thorough regulation of the BOCs by both state and federal officials, the BOCs have been allowed to outearn all other utilities and most competitive firms since divestiture.[21] A comparison of the 1985 market performance of the Regional Bell companies with all other utilities and the nation's largest corporations show that telephone ratepayers—both residential and business—paid the BOCs $1.25–2.0 billion more than the companies needed to match the earnings of either regulated or competitive firms.[22] Also, costly debt restructuring and accelerated depreciation of equipment added another $1.25–1.5 billion in unnecessary, 1985 ratepayer charges.[23]

Although the FCC recently reduced the Regional Bell companies' rate of return, and some state regulators have started to reduce these ratepayer overcharges, we believe BOC earnings must be brought back into line with the marketplace before MFJ restrictions are lifted. It is impossible to prevent cross-subsidization by companies that provide both monopoly and competitive services unless regulators establish a standard for evaluating the marketplace performance of these companies. We believe that whether or not rates are rising, overcharging for regulated services can only be prevented if state and federal regulators develop and implement an effective method of adjusting the BOCs' rates of return to reflect changes in market conditions.

CONCLUSION

CFA believes that ratepayer concerns must be addressed before Congress considers tampering with the terms and conditions of the Bell system breakup. Ratepayers' pocketbooks must be protected and the benefits of competition made available to all consumers before the Bell Operating Companies are allowed to enter competitive markets. Until policymakers develop regulatory tools that properly allocate the cost of jointly used equipment and resources, consumers have more to lose than gain from local phone company diversification.

(The following information was subsequently received for the record:)

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. Do you think that lifting the line-of-business restrictions from the Bell Companies would result in lower telephone rates?

Answer. The Consumer Federation of America (CFA) believes that lifting the line-of-business restrictions from the Bell Companies will not result in lower telephone rates.

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[21] Dr. Mark N. Cooper, Local Rate Increases in the Post-Divestiture Era: Excessive Returns to Telephone Company Capital, Consumer Federation of America, September 1986.

[22] Id., at 16–26.

[23] Id., at 27–35.

Question. Wouldn't consumers benefit from a lifting of the line-of-business restrictions? Wouldn't new services be provided?

Answer. While consumers may benefit if the Bell Companies are allowed to offer new services, CFA believes consumers have more to lose, through increase in basic phone rates, than to gain through lifting the line-of-business restrictions.

Question. Does the FCC have adequate jurisdiction over the RBOCs to develop accounting safeguards to prevent cross-subsidization between regulated and new unregulated ventures? In other words, can the FCC oversee potential cross-subsidy between local or intrastate services and new businesses?

Answer. In addition to the inherent problems associated with trying to prevent cross-subsidization through accounting safeguards (described in CFA's written testimony to the Committee), CFA believes the FCC lacks adequate jurisdiction over the RBOCs to develop accounting safeguards that would prevent cross-subsidization.

Question. Specifically, what control over local exchange, intrastate long distance, Yellow Pages, information services or manufacturing does the FCC have now and what control should they be given?

Answer. While the FCC may preempt state regulatory practices that impede attainment of the goals Congress set out in the Communications Act, the Commission may not interfere with the purely intrastate regulatory actions of the states. In addition, FCC involvement in issues relating to the Yellow Pages, information services and manufacturing is specifically circumscribed by the Modified Final Judgement.

Given the current holding—company structure of the Telephone industry, with many RBOC activities outside the jurisdiction of the states, gaps in regulatory oversight make it impossible to devise accounting safeguards that will prevent cross-subsidization. Unless Congress wishes to amend the Communications Act to give the FCC sole responsibility over affordable phone service, it may by impossible to prevent cross-subsidization through FCC accounting practices.

Question. Is it possible to require the states to develop regulatory mechanisms to protect ratepayers in view of the lack of jurisdiction the FCC has in these areas? How?

Answer. Congress may urge the states to devise particular regulatory programs, or set minimum cost allocation mechanisms that would protect ratepayers and promote interstate commerce. CFA believes the ratepayer protection proposal devised by Representative Ron Wyden (D—OR) is the best legislative suggestion currently under consideration in the Congress to promote adequate ratepayer protection in the states.

Question. What guarantees do ratepayers have that they will not be funding all kinds of high technology equipment in the local telephone network information services that they don't need or want?

Answer. Unless Congress develops a specific package of cost allocation mechanisms that prevent cross-subsidization, CFA believes ratepayers cannot be certain that consumers who only want basic phone service will end up payng for no more than basic phone service. The line-of-business restrictions should not be lifted until ratepayers are assured that affordable basic phone service will be preserved.

The CHAIRMAN. Thank you, Mr. Kimmelman.

Mr. Fischer?

Mr. FISCHER. Chairman Danforth and Members of the Committee, my name is Jim Fischer. I am a Commissioner with the Missouri Public Service Commission, and also a member of the Communications Committee of the National Association of Regulatory Utility Commissioners generally referred to as the "NARUC".

Accompanying me today is Bruce Hagen, a Commissioner with the North Dakota Public Service Commission, and Chair of the NARUC Committee on Communications.

NARUC is a quasi-governmental nonprofit organization established in 1889. Its membership is wholly governmental and includes the agencies of the 50 States engaged in the regulation of utilities and carriers. Our mission is to serve the American consumer by assuring that the regulated services are safe, adequate, and affordable.

The members of NARUC appreciate this opportunity to make our views known on Senator Dole's bill and many of the amendments proposed by Chairman Danforth. Coming from the Chairman's home State of Missouri, it is a particular pleasure for me to have the opportunity to participate. It is also a pleasure for me to have an opportunity to comment on Senator Dole's bill since I happened to have been born in Russell, Kansas, the home town of the Senator.

To begin with, NARUC does not support or oppose the pending legislation as it is written, since we respect both the regulatory role of the FCC and the antitrust role of the Federal judiciary. We believe in particular that Judge Harold Greene of the United States District Court of the District of Columbia has been quite responsive to our concerns for universal service at affordable rates in his administration and formulation of the Modified Final Judgment.

However, we do have concerns that we would like to express regarding any diversification legislation that might be considered by Congress. An indispensable goal of diversification legislation must be to preserve universal telephone service at affordable rates. We believe that the legislation should incorporate many of the proposals that Chairman Danforth issued with the Notice of these hearings.

In addition, the Committee should also seriously consider some of the amendments by Congressmen Wyden, Bryant, Swift, and Tauke.

Secondly, we believe that any telecommunications legislation must expressly retain State jurisdiction under section 152(b) of the Communications Act of 1934. Therefore, we believe that any diversification legislation should directly amend and become a part of the Communications Act of 1934. The scope of the legislation must be clearly restricted to the interstate aspects of diversification which are beyond the ability of the states to adequately address.

The centerpiece of the legislation must be to protect local exchange telephone customers from rate increases brought about by telephone company diversification into new and often highly competitive markets. Strict safeguards must be instituted to assure that the economic risks and the costs of new unregulated ventures not be borne by captive telephone customers.

State commissions must also be given access to all relevant books and records whether the new venture is conducted through a separate subsidiary or directly as a part of the telephone company itself.

Finally, we respectfully request that the States be made a part of the Federal decisionmaking process. By utilizing an administratively final Federal-State joint board to develop rules for considering lifting restrictions on the Bell Operating Companies and other related diversification decisions.

The joint board process has worked with success at the FCC. We believe that it could also be a constructive method for finding an appropriate balance for the interests involved in these difficult diversification issues.

In conclusion, if it is the will of the Congress to enact diversification legislation in the field of telecommunications, we pledge ourselves in cooperation with our colleagues at the FCC to make it work.

Before concluding, I would also indicate that I have been requested to submit for the record a written statement by the New York Public Service Commission.

Thank you very much.

[The statement follows:]

STATEMENT OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

Mr. Chairman and Members of the Committee: My name is James M. Fischer, and I am a Commissioner of the Missouri Public Service Commission and a member of the Committee on Communications of the National Association of Regulatory Utility Commissioners, generally referred to as the "NARUC". Accompanying me today is Bruce Hagen, a Commissioner of the North Dakota Public Service Commission and the Chair of the NARUC Committee on Communications.

The NARUC is a quasi-governmental nonprofit organization established in 1889. Its membership is wholly governmental and includes the agencies of the fifty States engaged in the regulation of utilities and carriers. Our mission is to serve the American consumer by assuring that the regulated services are safe, adequate and affordable.

The members of the NARUC appreciate this opportunity to make their views known on S. 2565, a bill proposing the Federal Telecommunications Policy Act of 1986, and many of the amendments proposed by Senator John Danforth, the distinguished Chairman of this Commitee.

To begin with, the NARUC does not support or oppose the pending legislation since we respect both the regulatory role of the Federal Communications Commission (FCC) and the antitrust role of the Federal judiciary. In particular, we believe that Judge Harold Greene of the United States District Court here in the District of Columbia has been quite responsive to our concerns for universal service at affordable rates in the formulation and administration of the Modified Final Judgment in the AT&T Divestiture Case.

However, if there is to be legislation, and that certainly appears to be the case, then we have strongly held views as to what that legislation must contain.

UNIVERSAL SERVICE AT AFFORDABLE RATES

An indispensable goal of diversification legislation must be to preserve universal telephone service at affordable rates. Or, to put it more simply, there will be no universal service without affordable rates.

First, diversification legislation must directly amend, and become a part of, the Communications Act of 1934, as amended, so as to lock-into FCC administration the overriding Congressional purpose of making "available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide . . . communication service with adequate facilities at reasonable charges . . .". 47 U.S.C., Sec. 151. Also, amending the Communications Act would avoid any impingement of the State regulatory role over intrastate communications which is a time-proven method for keeping local service affordable. 47 U.S.C., Sec. 152(b).

Accordingly, we believe that S. 2565 should be completely rewritten to reflect many of the consumer safeguards proposed by Chairman John Danforth issued with the notice of these hearings, and by Congressmen Ron Wyden, John Bryant, Al Swift and Thomas Tauke which appeared in the Congressional Record of August 15, 1986 (pages H6428-H6432, E2988-E2992). And the rewrite should be as statutory prescriptions to appear in the Communications Act and not as FCC regulations as presently called for by S. 2565.

The scope of the legislation must be clearly restricted to the interstate aspects of diversification which are beyond the ability of the States to adequately address. On the other hand, the intrastate aspects must be reserved for the exercise of State authority since the State commissions are in the best position to protect local ratepayers against the ever present potential for abuses from a diversified structure. Accordingly, the States must retain their authority to approve or disapprove proposed diversifications and, when approved, to prescribe and enforce the accounting rules and other procedures as necessary to protect local telephone ratepayers.

The centerpiece of the legislation must be to protect local telephone customers from rate increases brought about by telephone company interstate diversifications into new and often highly competitive markets. Strict safeguards must be instituted to assure that new ventures in the unregulated sector are carried out through separate subsidiaries, or if it is practicable to do so through the telephone company itself, that the direct and indirect costs of the venture be allocated to it. State commissions must be given complete access to all relevant accounts of these unregulated businesses, whether conducted directly by the telephone company or through a subsidiary, to assure the protection of ratepayer interests.

Also, we believe the Committee should give careful consideration to a broad application of the proposal by Congressman Ron Wyden for a telephone company to pay up to five percent of the gross revenues (or profits) of an unregulated business to reduce the bills of its affiliated local telephone ratepayers. Clearly, such a business will receive substantial intangible benefits in the competitive arena from the name recognition and reputation of the telephone company which, after all, were built-up and are maintained by the ratepayers.

FEDERAL-STATE JOINT BOARDS

Since diversification legislation has such a direct impact on local telephone ratepayers, we respectfully urge that the States be made a part of the Federal decisionmaking process applicable to interstate diversification issues by incorporating the Federal-State Joint Board process, which has worked so well over the years in strengthening intergovernmental cooperation for the benefit of local ratepayers.

The FCC, as the national and international regulator understandably bears an insulation from local problems, whereas the State commissions are on the "firing line", fully susceptible to the concerns of your constituents over the pricing of local telephone service. Clearly, a balance is called for in the administration of the delicate issues addressed by the legislation.

The Joint Boards have worked with great success at the FCC. There are now four operating concurrently to address the issues of cost separations and access charges (Dockets 80-286, 78-72), access minutes of use (Docket 85-124), Alaska rate integration (Docket 83-1376), and accounting procedures (Docket 86-297). The first Joint Board I mentioned effectively defused the politically "hot" access charge issue by agreeing in 1984 upon a one dollar per month charge for residential and single line business customers effective June 1985 and increasing it to two dollars per month in June 1986. The FCC had originally proposed a charge of two dollars per month beginning in 1984 with an escalation from there. Docket 78-72.

The United States Supreme Court in its landmark decision on May 27 in *Louisiana Public Service Commission* v. *FCC*, 90 L Ed 2d 369, 386, upholding State jurisdiction over depreciation rates for intrastate telephone ratemaking purposes, recognized the Federal-State Joint Board process as a vehicle for resolving the tensions inherent in our dual system of regulation. Sponsors of the diversification legislation in the House (H.R. 3687, H.R. 3800) also propose the use of the Federal-State Joint Board. Congressional Record, August 15, 1986, pages H6428-H6432, E2988-E2992.

With respect to kind of Joint Board to be employed, we recommend the administratively final one composed of all five FCC commissioners and four State commissioners, nominated by the NARUC and appointed by the FCC, who would make the final administrative decision, subject to Federal judicial review.

This Joint Board was incorporated in the universal telephone service preservation legislation in the last Congress (S. 1660, H.R. 4102) which overwhelmingly passed the House, but was tabled by a close vote on the Senate floor when the FCC agreed to delay the advent of the access charge for residential and single line business customers until June 1985 and thereafter capping it at four dollars per month until 1990. As mentioned above, an existing Joint Board won a substantial consumer victory by reducing it to a much lower level.

As a lesser preferred alternative, we suggest the employment of the existing type of Joint Board, composed of three FCC commissioners and four State commissioners, who would prepare a recommended decision for review and disposition by the FCC. 47 U.S.C., Sec. 410(c).

CONCLUSION

In conclusion, the theme of the NARUC's 98th Annual Convention to be held in Phoenix in mid-November of this year is "The Thrill of the Challenge, The Agony of the Change", which tersely characterizes the role of State regulators today.

We are now engaged in the complicated, and sometimes contradictory task of stimulating competition in the communications, energy and transportation fields where adequate markets exist to protect the public and, on the other hand, maintaining the shield of regulation for those who have no real choices.

If it is the will of the Congress to enact diversification legislation, we pledge ourselves, in cooperation with our colleagues at the FCC, to make it work.

Thank you for your consideration of our concerns.

NOTE.—California and New York do not agree with all aspects of this statement and, accordingly, will be filing their own views separately

(The following information was subsequently received for the record:)

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. Do you think that the states should participate in each decision made about whether to waive, modify or lift a line of business restriction? Should the states participate in any such decision through a federal-state joint board?

Answer. Under the existing provisions of the Communications Act of 1934, a dual federal/state regulatory system has been created. *See Louisiana Public Service Commission* v. *FCC,* 106 S. Ct. 1890 (1986). Section 152(b) of the Act specifically states:"nothing in this act shall be construed to apply as to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service of any carrier." NARUC's position is that any diversification legislation must maintain this reservation of authority to the States, and as a result, any diversification legislation must be "jurisdictionally neutral." In other words, the diversification legislation should not transfer any jurisdiction which presently resides with the State jurisdictions to the FCC or any other authority. The diversification legislation itself must be clearly restricted to the interstate aspects of diversification. It would be desirable to include in the legislation a specific reservation of jurisdiction to the states with regard to intrastate, interLATA and other intrastate services.

Since diversification legislation could have a direct impact on local telephone ratepayers, however, NARUC believes that the States should be made a part of the Federal decision-making process applicable to interstate diversification issues by incorporating the Federal-State Joint Board process with regard to the development of the rules necessary to comply with the requirements or safeguards of the diversification legislation itself and for defining functionally-related lines of business. In particular, the rulemaking process under the Federal-State Joint Board auspices would include the rulemaking for assigning and "allocating all costs of factors of production which are in any way used in lines of business authorized by this Act." See NARUC Proposed Amendment to S 2565, Sections 2 and 3. (Appendix B).

After the interstate rules were established through the Federal-State Joint Board process, the FCC would subsequently make the decision to waive, modify or lift particular lines of business restrictions for a particular company for interstate services only. State commissions, undoubtedly, would desire the opportunity to participate in this FCC process through the filing of written comments. However, it would be the FCC, not the Federal-States Joint Board or a state commission, which would make the decision whether a particular line-of-business restriction should be waived, modified or lifted for a particular Regional Bell Operating Company (RBOC). Of course, any FCC decision would have to be consistent with the rules established by the Federal-State Joint Board which were designed to comply with the safeguards stated in the diversification legislation itself.

With regard to intrastate services, the question of whether to permit an RBOC to engage in a previously restricted line of business would be decided by the individual states through the existing state procedures.

To illustrate this process, assume diversification legislation was adopted that included safeguards against cross-subsidies of competitive services by local exchange services, and a requirement that rules be developed to ensure compliance with the safeguard. If the RBOCs applied to have the interLATA line of business restriction waived, the Federal-State Joint Board would first establish the rules designed to guard against cross-subsidization. After these rules were established by the Federal-State Joint Board, then the FCC would decide whether the line of business restriction in the Consent Decree would be waived and whether an RBOC should be permitted to enter the interstate, interLATA market. Individual state commissions would decide the issue of whether the RBOC would also be permitted to enter the intrastate, interLATA market in a particular state and what additional safeguards, if any, should be developed for intrastate ratemaking purposes.

If an individual state does not presently have jurisdiction over the question of whether an RBOC enters a particular market (e.g. manufacturing of CPE), the only participation of the States in the process would be in the development of the rules for complying with the safeguards of the diversification legislation, or through participation as an interested party before the FCC. Of course, the states would have jurisdiction to ensure that previously deregulated services do not burden intrastate services.

Question. Does the FCC have adequate jurisdiction over the RBOCs to develop accounting safeguards to prevent cross-subsidization between regulated and new unregulated ventures? In other words, can the FCC oversee potential cross-subsidy between local or intrastate services and new businesses?

Answer. The FCC's jurisdiction over the RBOCs appears to be adequate insofar as interstate diversification issues are concerned. In April of this year, the FCC initiated a rulemaking proceeding for the express purpose of ensuring that ratepayers in the interstate jurisdiction, including RBOC customers, will be adequately protected from the potential burdens of cross-subsidies between unregulated ventures and regulated services. *See Separation of costs of regulated telephone service from costs of non-regulated activities*, cc Docket No. 86-111, (April, 1986). Pursuant to that objective, the FCC has proposed certain accounting procedures and cost allocation standard for those telephone companies under its jurisdiction that provide both regulated and unregulated services and products. The current proceeding by the FCC is an continuation of and expansion on other proceedings which have been initiated by the FCC to address, among other things, cross-subsidy concerns. See e.g. *Second Computer Inquiry*, 77 FCC 2d 384 recon 84 FCC 2d 50 (1980), further recon., 88 FCC 2d 512 (1981) aff'd sub. nom. *Computer & Communications Industry Ass'n* v. *FCC*, 693 F. 2d 198 (D.C. Cir. 1982). *cert. denied* 461 U. S. 938 (1983); *Third Computer Inquiry*, FCC 85-397 (1985).

Although the scope and nature of the FCC's jurisdiction over the RBOCs has not been definitively determined, the courts have upheld FCC attempts to impose subsidy safeguard requirements on various services provided by RBOCs and their subsidiaries or affiliates. *See Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services, and Cellular Communications Services by the Bell Operating Companies* (BOC Separation Order), 95 FCC 2d 1117, recon. FCC 84-252 (released June 1, 1984), aff'd sub nom. *Illinois Bell Telephone Company* v. *FCC* 740 F. 2d 465 (7th Cir. 1984), *decision on recon. aff'd North American Telecommunications Ass'n* v. *FCC*, 772 F. 2d 1282 (7th Cir. 1985). Absent an unexpected judicial determination to the contrary, it therefore appears that the FCC has adequate jurisdiction over RBOCs to address diversification issues affecting the interstate services offered by the RBOCs.

On the other hand, potential issues involving cross subsidies betwen local or intrastate services and new businesses are matters which are properly addressed by the state commissions. As previously noted, the Communications Act of 1934 envisions a system of dual federal/state regulation. Consistent with this traditional separation of power, NARUC believes that the authority to oversee diversification issues involving local or intrastate services clearly resides with the state legislatures and commissions. That is not to suggest that state commissions and the FCC should not cooperate through appropriate regulatory avenues in an effort to develop common approaches to diversification issues, but rather that the states are entitled to adopt their own regulatory solutions where necessary.

Question. Specifically, what control over local exchange, intrastate long distance, yellow page, information services or manufacturing does the FCC have now and what control should they be given?

Answer. Local exchange, intrastate long distance and, to a lesser extent, yellow page services have traditionally been regulated by state utility commissions. In addition, the provisioning of customer premises equipment (CPE) by telephone companies to their customers was also fully regulated by the state commissions until detariffed by the FCC in various decisions over the past five years. In contrast, the manufacture of CPE and other telephone plant facilities has never been directly regulated, although the FCC has established certain minimum technical standards to ensure that such equipment is compatible with the public telephone network. The FCC has also largely deregulated "enhanced" services, which arguably include information services.

While the dividing line between federal and state jurisidiction under the Communications Act of 1934 has often been subject of debate and litigation, the United States Supreme Court recently offered some specific guidance on the question. In *Louisiana Public Service Commission* v. *FCC, supra*, the Court reviewed various FCC orders which established new depreciation charges and practices for telephone plant and equipment. The question before the Court was whether the FCC's depreciation orders pre-empted state commissions from establishing inconsistent depreciation charges and practices for purposes of setting rates for intrastate telephone service. In concluding that the FCC could not dictate the depreciation practices of the state commissions, the Court noted that the Communications Act of 1934 envisioned a dual system of state and federal regulation. More specifically, the Court cited Section 152(b) of the Act which specifically provides that the FCC shall not have jurisdiction with respect to "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service . . ." According to the Court, this statutory provision constituted a congressional denial of power to the FCC to require the state commissions to follow FCC depreciation practices for intrastate ratemaking purposes.

The Court's holding in *Louisiana* clearly indicates that the FCC's control over local exchange, intrastate long distance, yellow page and other intrastate services is limited by the jurisdictional restrictions set forth in the Communications Act of 1934. As previously mentioned, NARUC believes that any diversification legislation must be "jurisdictionally neutral." Accordingly, I would not recommend that the FCC be given any control over these intrastate services which is inconsistent with the existing systm of dual regulation.

Question. Is it possible to require the state to develop regulatory mechanisms to protect ratepayers in view of the lack of jurisdiction the FCC has in these areas? How?

Answer. As previously discussed, the FCC's jurisdiction with respect to the regulation of intrastate communications services is expressly limited by Section 152(b) of the Federal Communications Act of 1934. As the above question suggests, this legislatively-created limitation has implications regarding the FCC's jurisdiction to require the states to develop certain regulatory mechanisms relative to the provisioning of intrastate services. For example, in *Louisiana Public Service Commission* v. *FCC, supra*, the United States Supreme Court construed Section 152(b) as a "congressional denial of power to the FCC to require state commissions to follow FCC depreciation practices for intrastate ratemaking purposes." In instances where intrastate services are involved, such reasoning would presumably invalidate similar efforts by the FCC to require that states develop or follow specific regulatory mechanism established by the FCC.

In any event, before any effort is made to impose federal requirements on the states in this area, state legislatures and commissions should be permitted to develop their own regulatory mechanisms in order to ensure that telephone company diversification does not impose inappropriate burdens on basic telephone service ratepayers. As discussed below, state commissions have the authority and resources to develop regulatory policies which are tailored to the particular needs and circumstances of the consumers within their respective states. More importantly, state commissions have an additional incentive to develop safeguards which will protect local ratepayers given the fact that they are closer and more directly accountable to those consumers. Under such circumstances, there is no reason to assume that the states will be unable or unwilling to develop effective regulatory mechanisms to serve these important objectives.

Question. What guarantees do ratepayers have that they will not be funding all kinds of high technology equipment in the local telephone network information services that they don't need or want?

Answer. Even in the absence of increased diversification, there are no ironclad guarantees that local telephone ratepayers will not have to fund certain types of high technology equipment that may not be specifically needed to serve them. However, the FCC and the state commissions do have powers and resources which can be employed to ensure that the costs incurred by RBOCs to provide various types of information and other telecommunications-related services are not inappropriately allocated to local telephone ratepayers. As discussed previously, the FCC has initiated a variety of proceedings in which it has attempted to develop regulatory mechanisms designed to guard against cross- subsidy of non-regulated ventures by regulated services. See e.g. *Separation of costs of regulated telephone service from costs of non-regulated activities*, cc Docket No. 86-111 (1986); *Second Computer Inquiry*, 77 FCC 2d 384 *recon* 84 FCC 2d 50 (1980), *further recon.*, 88 FCC 2d 512 (1981), *aff'd sub nom. Computer & Communications Industry Ass'n* v. *FCC*, 693 F. 2d 198 (D.C. Cir. 1982), *cert. denied* 461 U. S. 938 (1983); *Third Computer Inquiry*, FCC 85-397 (1985).

At the state level, public utility commissions have the authority and obligation through rate case proceedings, rate design investigations and other state regulatory mechanisms to ensure that the rates paid by local telephone ratepayers are just and reasonable. In fulfilling that obligation, the state commissions may consider a variety of factors, including whether telephone company facilities are "used and useful" and on whose behalf those facilities have been installed. Based on these types of evaluations, the state commissions may adopt rate design policies or disallow inappropriate costs in order to protect ratepayers from unreasonable cost burdens. Given their extensive experience in allocating telephone company costs between different types of services, including both competitive and non-competitive services, state commissions should be adequately equipped to perform these responsibilities in a satisfactory manner.

The Chairman. Thank you, sir.

Mr. Stowe?

Mr. Stowe. Thank you, Mr. Chairman. I am Ronald Stowe, Vice President for Washington Operations of the Pacific Telesis Group.

We would like to support the passage of S. 2565. We believe that the procedural and administrative goals of this bill are extremely important in their own right, and apart from any later decisions about the substance of how to deal with the Consent Decree. We believe that it is no longer appropriate to continue the dual regulation of the BOCs by both the court and by the FCC. In fact the remaining issue really is the degree of congressional direction that should be provided to the FCC in its new mandate.

Opponents of S. 2565 have commonly expressed concerns about the preservation of fair competition: Should the BOCs be allowed to enter markets which are now open to those opponents but generally proscribed to the BOCs? It is essential in our view, however, to differentiate between ground rules which are necessary for fair competition, which would be quite acceptable, and simple market protectionism which would not be.

In all candor, it seems that many of the opponents of this legislation and some of the modifications that have been proposed to it are more concerned about additional competition than they are about fair competition. We are prepared to test the services we would like to offer in the marketplace, and we are prepared to ensure that others have the opportunity to compete fairly. We believe that safeguards can be developed which will ensure fair treatment of competitors and affiliates alike.

We believe that the FCC, combined with congressional direction, are perfectly capable of developing such safeguards.

Because the debate over this bill has expanded beyond procedural and administrative aspects, however, we would like to make a few comments about one of the areas, one of the line-of-business restrictions, in which the Pacific Telesis Group has a strong particular interest—namely, the information service restriction.

We believe the public demand, individual and business, for information services will escalate rapidly once those services are easy to acquire, convenient to use, and reasonably priced. We feel that removal of the current restriction is critical so that in fact the benefits of the long touted information age can be brought to consumers through the public telecommunications network, not just to large businesses which can afford expensive customer premises equipment.

There are very practical consequences for both businesses and individuals in this regard. Network-based information services could provide extremely valuable mainstream commercial and financial information, health care, environmental monitoring, and safety and educational services. Capabilities exist, for one example, for converting voice signals into visual or braille form, opening vast new information resources for the hearing impaired and the blind, and in reverse for converting communications from the hearing impaired into voice form, permitting effective communications across the entire telephone system.

Information resources available to individuals and businesses in rural and remote areas of the country could also be greatly increased through use of network-based information services. Government policy should not and need not encourage development of a system which as a practical matter really serves only the major metropolitan centers. In fact, however, it may be only through the telephone network that many areas of our country will have access to these new services and benefits.

We believe that removing the constraints on BOC participation in the information services industry would have a positive impact both on our domestic economy and on our international balance of trade. The MFJ's prohibition of network-based information services has discouraged the introduction of advanced intelligence into the network into which the United States is a world leader, and encouraged the use of customer premises equipment in which the United States is the world's greatest importer.

Nearly 50 percent of the CPE now being used is imported from foreign sources. In contrast, 93 percent of the equipment used in Pacific Telesis network is manufactured in this country. In other words, the impact of removing these restrictions goes far beyond the dollars actually involved in the telecommunications equipment and trade itself.

We believe that the overall productivity of the United States economy, of individuals, of small businesses as well as large businesses, could be greatly enhanced by encouraging our society and our economy to take full advantage of the high technology and the new kinds of services that can be made universally available if we use the networks provided by the operating companies.

Thank you.

[The statement follows:]

STATEMENT OF RONALD F. STOWE, VICE PRESIDENT, WASHINGTON OPERATIONS, PACIFIC TELESIS GROUP

Thank you for the opportunity to testify before this committee. I am Ronald Stowe, Vice President of Pacific Telesis Group.

Pacific Telesis Group supports S. 2565 and encourages its prompt passage. The bill would centralize federal jurisdication over a large segment of the telecommunications industry in the regulatory agency which has specifically been given the resources and the congressional mandate to implement national telecommunications policy—the Federam Communications Commission.

We think it is unfortunate that the debate has shifted away from the merits of a unified national regulatory policy.

Pacific Telesis wishes to stress that the procedural and administrative goals of the Dole Bill are extremely important in their own right and apart from any later decisions about the substance of the Consent Decree. As Chairman Danforth said last week, the vast majority of respondents would agree that it is no longer appropriate to continue dual regulation of the BOCs by the Court and the FCC; it is clear that the FCC is the appropriate single entity to oversee the activities of the BOCs. The remaining issue is the degree of congressional direction that should be provided to the FCC.

Opponents of S. 2565 express concerns about the preservation of "fair" competition, should the BOCs be allowed to enter markets which are now open to those opponents but currently proscribed to the BOCs. It is essential, however to differentiate between ground rules which are necessary for fair competition, on one hand, and simple market protectionism, on the other. We are concerned that many of the opponents of S. 2565, while talking about ratepayer protection and fair competition, are really only interested in keeping aggressive new entrance out of the market.

We are prepared to test the services we offer in the marketplace, and we are prepared to ensure that others have the opportunity to compete fairly against us. We believe that safeguards can be developed which will ensure fair treatment of competitors and affiliates alike.

For example, the safeguards imposed by the FCC in its Third Computer Inquiry, including accounting controls and some form of comparably efficient interconnection leading to an "open network architecture" for other service providers, are likely to be the best vehicle for ensuring that any new services are provided and provided fairly.

The FCC's expert application of a public interest test, under Congressional oversight and guidelines, is the appropriate method for determining whether the Consent Decree prohibitions should be lifted.

Because the focus of the debate forces a response, in addition to our endorsement of Senator Dole's bill, we would like to make a few comments about the information services restrictions in the AT&T Consent Decree.

We believe that the demand for such services will escalate rapidly once those services are easy to acquire, convenient to use, and reasonably priced. We feel that the removal of this restriction is critical so that the benefits of the information age can be brought to all consumers through the public telecommunications network, not just to large businesses which can afford expensive customer premise equipment. The types of information services that we are talking about generally involve voice storage and retrieval and message or data processing.

For example, network-based information services could provide extremely valuable commercial and financial information, healthcare and environmental monitoring and analysis, and safety and eductional services.

In addition, capabilities exist for converting voice signals into visual or braille form, opening vast new information resources to the hearing impaired and blind, and for converting communications from the hearing impaired into voice form, permitting effective communications across the telephone system.

Information resources available to individuals and businesses in rural and remote areas of the country could also be greatly enhanced through the initiation of network-based information services; government policy need not and should not encourage by default development of a system which actually serves only the major metropolitan centers. In fact, it may be only through the telephone network that many areas of our country will have access to these benefits.

In all areas of the country, residential and business customers could more economically and efficiently gain access to computer information if code and protocol conversion capabilities were available in the network. Such capabilities would allow different types of computers to easily "talk" with each other without each party requiring expensive terminal equipment.

While Pacific Telesis does not believe that even the higher levels of conversion are an information service, and split in federal jurisdiction causes continued uncertainty and inhibits further development.

In addition, we believe that removing the constraints on BOC participation in the information services industry would have a positive impact on both our domestic economy and our international balance of trade. The U.S. telecommunications market is focused primarily on customer premise equipment (much of which is foreign made) as the source of new services. The MFJ's prohibition of network-based information services has discouraged the introduction of advanced intelligence into the network in which the U.S. is a world leader, and encouraged the use of CPE, of which the U.S. is the world's largest importer.

The U.S. trade deficit is a symptom of declining U.S. competitiveness. In order to compete more successfully with other countries, U.S. industry must enhance productively by increasing efficiency. Efficiency of all industries—from farming to finance, mining to manufacturing—would improve if these industries had better access to information and information processing through the public telecommunications network.

As long as the Government prohibits or discourages the development of this capability within the network, it also discourages use of these innovative services by all but the largest companies and institutions which can afford their own sophisticated CPE.

Many other nations, including our major trade rivals, are aggressively developing the intelligence in their networks in order to expand the competitive advantage of their industries. If the MFJ continues to block our network development, the U.S. will fall further behind. If, however, network development is set free, we strongly believe that America's network can outpace all others, and that substantial benefits will flow to our entire nation.

In conclusion, Mr. Chairman, we would like to stress two points:

First, fair competition and network-based information services are not mutually exclusive; however, the MFJ currently precludes both.

Second, more extensive and innovative use of the local telecommunications network for information services will benefit large and small users, service providers, and the ratepayers who subscribe to traditional services.

In addition, if the Congress decides to address the substance of the line of business constraints at this point, we strongly urge that the FCC be directed to eliminate the current prohibitions on BOC offerings of a broad range of information services. The benefits of the information age are coming throughout the world. Allowing the BOCs to provide those services is the only way to ensure that those benefits are widely available here.

We support the proposal to make the FCC responsible for administering the restrictions currently embodied in the MFJ, and for applying the broad public interest standard to any changes. Therefore, we support S. 2565 and encourage this Committee's prompt consideration and passage of the Bill.

Thank you.

(The following information was subsequently received for the record:)

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. What is the appropriate time limitation for FCC action on a pending petition.

Answer. Given the competitive nature of many of the lines of business, involved petitioners should be able to expect a decision from the FCC within 4 months of filing.

This time frame is important bacause in providing informatoion to the FCC the Regional Holding Companies (RHCs) must reveal information about their business plans to their competitors. A long process would put the RHCs at a distint competitive disadvantage.

The existing waiver process is too time consuming and cumbersome. While ten of Pacific Telesis Group's waiver requests have been granted some have taken as long as a year. Three Pacific Telesis Group waiver requests have been pending for over a year. The average ruling has taken over 6 months.

A long waiver process precludes the RHCs or any other participants from making normal business decisions which respond to customer needs and market opportunities. If the FCC were to merely substitute another long hearing process for the existing waiver process the RHCs would remain unnecessarily slowed in their ability to meet diverse customer needs.

Question. What are the relevant markets and submarkets for determining the potential effect on competition, e.g., should the domestic or world market be considered? What are the relevant goods and services markets?

Answer. The FCC should not regulate activities that the RHCs may wish to pursue in international markets. In reviewing whether the RHCs should enter particular lines of business, consideration should be given not merely to the effect of such entry on competition but whether such entry is in the public interest. With regard to the effect on competition, consideration should be given only to the domestic market, but should include any foreign competitors in that market.

Question. What standards should be used to evaluate the potential effects on trade and national security? For example, should the standard be that there is no substantial possibility of adverse impact on the balance of trade or U.S. trade policy objectives?

Answer, From a trade policy perspective this question would be better phrased in the positive rather than the negative. That is, removing the restrictions on the RHCs will stimulate markets in many areas and help the international competitiveness of the United States. Pacific Telsis Group feels that the burden should not be on RHCs to prove that their participation would not have such an impact.

The harm being caused to U.S. trade by the information services restriction is evidenced by the fact that our nation's principal competitors is evidenced by the fact that our nation's principal competitors in international trade recognize the importance of their own network-based information services. Japan, France and England are striving to expand the uses of their networks and to gain a head start in providing the most advanced information services to both domestic and international customers. These and other countries are exporting their telecommunications equipment and information services into the U.S. in ever increasing amounts. The impact of these changes can be seen in our trade figures. From 1982 through 1985 the U.S. trade balance in electronics based products experienced an over $14 billion shift from surplus to deficit. The Department of Commerce is forecasting that shift will have grown to some $20 billion by the end of 1986. This imbalance is harming the nation's economy and reducing the number of U.S. jobs.

These foreign countries are actively encouraging and supporting their local telephone companies' entries into the information services market. As these companies' use of technology develops, customers are increasingly being provided with access to innovative services which can help the companies gain competitive advantages in the international marketplace. Thus, both the foreign telecommunications companies and foreign companies which depend on telecommunications as an integral part of their businesses are becoming better positioned in U.S. and international markets. By restricting RHC entry into the information services market, the MFJ restriction is retarding the development of both the U.S. telecommunications industry and other U.S. industries which are dependent upon it. This decreases the international competitiveness of the United States.

Since network options are limited by the MFJ's information services restriction, the principal means for U.S. customers to obtain advanced services is through the purchase of sophisticated customer premises equipment (CPE). (About 90% of the on-line database services in the U.S. are accessed by busuness users—the customers able to afford the CPE investment.) A large portion of the CPE purchased in this country is manufactured in foreign countries. By comparison, about 93% of the equipment in Pacific Bell's network is manufactured domestically. Thus, by artificially encouraging the purchase of CPE, even by those who might prefer network options, the information services restriction is increasing the U.S. trade deficit.

The "national security" effects of eliminating current restrictions would be negligible. Some concern has been expressed that long distance services may become "Balkanized" if the RHCs were allowed to adopt network configurations which would be imcompatible with each other. Under the AT&T Consent Decree the National Security Emergency Preparedness Group (NSEP) was created at Bellcore. That organization coordinates national security related network issues among the BOCs and exists to ensure that the nationwise network will continue to exist in emergencies. All of the RHCs are represented in NSEP and tests simulating disasters are conducted on a regular basis across the nation. NSEP is a permanent member of the Defense Communications Agency which is part of the Department of Defense.

If the concern is that the BOCs will somehow attempt to restrict the ability of others to connect to the network, the Committee should know that the RHCs have consistently stated that enhanced connectivity is vital to the Information Age success of their regulated businesses. Pacific Bell is working with various industry participants to ensure that policy at the FCC includes Comparable Efficient Interconnection (CEI) which is discussed later in these responses. In addition, the FCC nonstructural safeguards, also discussed later, will help alleviate concerns regarding preferential or proprietary network interconnection protocols.

Further, the FCC fully understands these issues and will provide appropriate regulation.

Question. What weight should be given by the FCC to the findings and recommendations of other agencies? For example, should the relevant executive branch agency have veto power over a waiver if the agency determines that it would be likely to have a detrimental effect on the balance of trade or U. S. trade policy objectives?

Answer. It is not necessary that legislation establish particular requirements on regulators to seek out or give specific weight to the views of other agencies. The rules and regulations of the FCC provide for an open comment and reply cycle in which interested parties may participate. While keeping its statutory goal of universal service as the guide for its decisionmaking the FCC accords these comments the weight they deserve under the particular circumstances before the Commission.

It follows then, that the FCC should be the final arbiter of the opinions of the interested parties and no other agency should have "veto" power over FCC decisions.

Question. How much time should agencies have to provide their determinations to the FCC?

Answer. Because the FCC structures its hearing process through its rules and regulations this question is more properly addressed by the FCC. Clearly, if the FCC has a 4 month time limitation on the whole procedure then the comment period itself must be sufficient to allow time for response and analysis by the FCC staff.

Question. Should a distinction be drawn between entry into a competitive market through acquisition versus independent entry?

Answer. Conventional antitrust analysis would say that if the entry into the competitive market was truly a new one by the RHC then it doesn't matter whether it is by start-up or by acquisition. In any event, the Hart-Scott-Rodino Act already provides for Justice Department review of any sizeable acquisitions.

Question. How should the FCC analyze the costs and benefits of regulation?

Answer. In engaging in a cost/benefit analysis of regulation the FCC should continue to pursure public interest policies which maximize consumer welfare. That entails maintaining universal service at a reasonable price and providing residential and business customers with Information Age services while avoiding cross-subsidy problems and discrimination in interconnection of other vendors of telecommunications services.

The FCC and the Congress should accept the premise that the entry of serveral well-financed companies into the same markets will serve to enhance competition and benefit both the residential and business consumer.

Question. Are the FCC's current regulations an effective check? Is state regulation an effective check? What requirements should be set forth in legislation?

Answer. Existing and pending accounting and cost allocation regulations provide an effective check on the activities of the RHCs.

Both the FCC and the state commissions regularly audit Pacific Bell's books and records as they relate to regulated operating company transactions with its parent holding company or any of the affiliates of that holding company.. Their oversight, coupled with internal and third party audits sponsored by Pacific, will ensure that ratepayers are not affected by the PacTel Companies unregulated market activity. In fact, the California Public Utilities Commission recently completed an exhaustive 15 month audit of transactions of this type.

As an illustration of how this process works, the FCC requires Pacific Telesis Group to file, on an ongoing basis. Shared Administrative Service plans for all subsidiaries in oder to effectively regulate transfer pricing and allocation of costs between Pacific Bell/Nevada Bell and the unregulated affiliates of Pacific Telesis Group. During the last half of 1985, the FCC completed a three-week audit of Pacific's books related to these issues. Only one aspect of Pacific's accounting methods was questioned, and that was quickly adjusted to accommodate the FCC's concerns. Thus, full safeguards are already in place for the offering of new services and products by the unregulated affiliates of the RHCs should the Consent Decree restrictions be removed.

In Computer Inquiry III (CI-III), the FCC decided to reverse its previous policy of requiring Pacific and other RHCs to create separate subsidiaries for enhanced services, since it recognizes the loss of consumer benefits associated with separating these services from the network. In its CI-III report and order released June 16, 1986, at paragraph 89, the FCC stated:

"Experience with the structural separation requirements for the divested BOCs established in the *BOC Separation Order* has demonstrated that those requirements hinder the introduction of enhanced services that could benefit the public by being widely and efficiently available through the BOCs' local exchanges. Structural separation imposes opportunity costs by discouraging the BOCs from designing innovation enhanced services that utilize the resources of the public switched network. Such innovation losses, resulting from the physical, technical, and organizational constraints imposed by the structural separation requirements, directly harm the public, which does not realize the benefits of new offerings."

The FCC has ordered numerous safeguards designed to protect ratepayers and competition while allowing development of new services and of our nation's telephone network. In its CI-III filing, Pacific recommended the following safeguards which together with other safeguards, were generally adopted by the FCC, although details are still being developed:

Financial/Accounting tracking and reporting. Pacific Telesis Group, with the help of Coopers & Lybrand, submitted a detailed plan to the FCC which would use accounting controls, rather than separate subsidiaries, to divide services offered through the core business.

Investments, expenses and revenues for enhanced and information services, including an appropriate share of joint and common costs, will in this way be isolated from those of all other services. This accounting plan assures regulators that the appropriate investments, expenses and revenues are applied to the appropriate services.

Tariff-type procedures. All integrated network services would be offered pursuant to either state or federal tariff-type procedures. This would allow public disclosure of the availability, features and conditions of the service, and would permit customers and competitors to file comments with the regulator on proposed services. The FCC could set broad rules and conditions for offering interstate access to integrated network services. Since most integrated network services will be exchange in nature, oversight of services, prices and terms would be left to the state regulators.

Audit controls. Regular audits will be conducted by the FCC, the California Public Utilities Commission and the Nevada Public Service Commission to ensure that all regulatory safeguards are being properly implemented. Periodic audits by the FCC should continue and could be expanded to include these new safeguards. The financial accounting plan would be audited annually by an independent accounting firm.

Comparably efficient interconnection to the network. One of the principles underlying CI-III is the need to ensure interconnection to the network for all information services providers in a manner that promotes competition.

CEI represents a recognition by the FCC that non-discriminatory interconnection requirements vary for different services. For some services, interconnection requirements are relatively simple to implement since the proper technology is in place. Once the FCC is satisfied that requirements are met for a particular type of service, RHCs could be allowed to offer that type of service without waiting until requirements are met for all services. Regulators and industry participants are used to dealing with such flexible systems, and this method would bring benefits to consumers without unnecessary delays.

Thus, these safeguards, and others developed by the FCC and state commissions are sufficient to protect the nation's telephone ratepayers and encourage open and fair competition in new markets.

It is the position of Pacific Telesis Group that no specific requirements of this type should be codified. The Congress should provide the FCC with policy guidelines and allow the expert agency to implement those guidelines as conditions warrant.

Question. What protection is offered by state regulation?

Answer. The various state regulatory bodies conduct regular audits in the intrastate ratemaking process. These audits, and the general ratemaking process, take into account a wide range of issues, including utility-parent holding company and holding company affiliate transactions, cost and pricing issues, and accounting and modernization issues. These audits afford another check on the possible misapplication of prescribed accounting standards. California's Public Utilities Commission has been particularly active in exercising its oversight function.

No additional federal action is necessary.

Question. Should the FCC be permitted to accept certification of outside public accountants in lieu of conducting its own audits?

Answer. Yes, the FCC should be permitted to accept certifications of outside public accountants in conjunction with its own audits. As long as the use of outside auditors does not interfere with the role of the FCC is providing guidance through its own auditing process we have no objection to the use of outside auditors.

Question. Should the FCC be granted further authority to impose cost-of-regulation fees on the competitive affiliates of telephone companies to recover the direct costs incurred by the FCC in conducting audits? If the FCC is permitted to assess auditing fees, how should those fees be calculated?

Answer. No. The purpose of deregulation was to foster competition. With the exception of PacTel Mobile Companies, none of the PacTel Companies receives any regulatory benefits from the FCC to justify seeking even partial auditing cost recovery from them. Fees of this type, paid by the competitive unregulated affiliates, would place a cost burden on them that other competitors will not have to suffer. The impact of such fees would be anticompetitive and unfair.

Even if the fees are imposed on the regulated businesses of the RHCs the fees would be inappropriate. If the Congress and the FCC deem it important enough to require ongoing review and audits of the relationships maintained by these entities then they should also allocate the resources sufficient to carry out those functions. It should not be the responsibility of the Regional Holding Companies or their subsidiaries to ensure that the FCC has an adequate operating budget.

It should be remembered that the customers of the RHCs are the ones who will ultimately bear the cost of these types of fees. Whether paid by the regulated or unregulated entities, this is inequitable.

Question. Would existing regulations, such as those currently imposed by the FCC regarding the disclosure of network information, be adequate if telephone companies were permitted to enter new, competitive lines of business?

Answer. Yes. Pacific has recommended that a six-month advance disclosure of intent to change the network in a way which would affect interconnection be required. This would ensure that no harm ensued to competitors from such changes.

Question. Without FCC regulation, how effective would anti-trust laws and FTC authority be to prevent unfair competition?

Answer. Existing antitrust laws will remain in force with or without FCC regulation in the telecommunications arena. These laws have proven to be more than adequate in preventing anticompetitive behavior.

Question. Would existing FCC regulations be adequate if the telephone companies were permitted to enter competitive lines of business?

Answer. Yes. The handling of customer proprietary information has been discussed in CI-III. In order to protect customers' privacy and at the same time allow vendors to satisfy customer needs through the network, customer proprietary information should be available, at the customer's request, to unaffiliated vendors or enhanced services.

Question. Should the equal access requirements imposed by the AT&T and GTE decrees be amended? Would the FCC's *Computer III* requirements be effective safeguards for the provisions of information services? What interconnection requirements should be set forth in legislation?

Answer. From our prospective, amending the equal access provisions of the AT&T Consent Decree is unnecessary. Pacific Telesis Group, including its regulated subsidiaries Pacific Bell and Nevada Bell, has long been committed to full compliance with these requirements.

Computer Inquiry III provides a sound basis for the FCC's regulation of the information services industry. Due to rapidly changing technology it would be unwise to enumerate technical interconnecton requirements in a statute. Interconnection requirements were discussed in more detail in response to the previous question concerning the adequacy of FCC regulations.

Question. Should the FCC require competitive affiliates to obtain their own debt (or other) financing on their own credit? Should S. 2565 be amended to prohibit any entity affiliated with a petitioning telephone company to guarantee the debt associated with a competitive venture in a manner that would permit a creditor, on default, to have recourse, to the assets of the local telephone company?

Answer. The proposal contained in this recommendation is currently Pacific Telesis and California Public Utilities Commission policy. Therefore, should the Committee choose to amend the Bill in this manner, Pacific Telesis could support that amendment.

Question. Should structural separations be required for certain lines of business? Are there cases in which non-structural safeguards would be inadequate to prevent cross-subsidization of a competitive venture of anticompetitive behavior? For example, should the entry of telephone companies into the manufacture of telecommunications equipment and provisions of long distance services be conditioned on a requirement of separate subsidiaries?

Answer. Current FCC and state regulations calling for non-structural safeguards and adequate to protect against cross-subsidization. Structural separations should not be codified. (See response question on page 6.)

Question. Should S. 2565 be amended to define the "manufacture" of telecommunications equipment? Should different standards apply to entry into various stages of the manufacturing process? For example, should a differentiation be made between permitting telephone companies to design and test telecommunications equipment, and permitting them to engage in production?

Answer. Pacific Telesis has no plans to enter into the manufacturing of telecommunications equipment, as we understand that term. For instance, we do not understand the term to prohibit us from specifying equipment to meet our sometimes specialized requirements, though some might consider that to be "design." As with most of the other detailed aspects of the Decree, we believe a definition of "manufacturing" is best left to the FCC.

Question. Should the FCC be required to consult with other expert agencies in promulgating such regulations? If so, which agencies would provide the necessary expertise?

Answer. The FCC comment procedure allows any interested party to participate in an FCC proceeding. Each proceeding is unique and, therefore, codification of specific agencies required to participate would not be productive.

Question. What is the effect of Section 10 of the Clayton Act?

Answer. While this section of the Clayton Act does refer to "common carriers" the cases are clear that the section applies only to railroad common carriers.

Question. Should the FCC procurement regulations distinguish between telecommunications equipment that was designed but not produced by a competitive affiliate? What other considerations are relevant?

Answer. The FCC should determine if such a distinction is necessary to protect all involved in the equipment market.

Question. Should separate subsidiaries be required for the manufacturing of telecommunications equipment?

Answer. The FCC should determine whether a separate subsidiary-type of structure is appropriate for those RHCs who choose to enter into manufacturing.

Question. Should AT&T and the BOCs be barred from providing electronic publishing services for a set time, or should a market dominance test be applied?

Answer. AT&T is currently barred from the provision of such services until 1989. To impose a specific time restriction on RHC participation in electronic publishing is unnecessary.

Rather than impose a time limitation, Pacific Telesis Group proposes that the FCC be given the authority to permit an RHC to offer electronic publishing services, but only if the local telecommunications facilities which the RHC uses for its electronic publishing are offered to all competitors for their electronic publishing services under the same terms and conditions, which include technical parameters. Thus, an RHC would be able to participate from discriminating against other electronic publishers.

As the appropriate federal regulator of communications activities, the FCC would be charged with developing required procedures and safeguards which would precede a RHC's entry into the electronic publishing business. In addition, consistent with its traditional role, the FCC would be charged with monitoring compliance and with enforcement of those provisions on a continuing basis, under the oversight of the Congress.

If electronic publishing is to be subject to additional restrictions then Pacific Telesis Group would recommend that the definition be narrowed. The Committee has suggested that the term "electronic publishing" be used as defined in the AT&T Consent Decree. We would suggest that the definition be changed to read as follows:

"Electronic publishing means the provision of information which is disseminated to an unaffiliated person *via telecommunications* and *has a substantial portion of its content devoted to the dissemination of news and editorial opinion*, that dominant interexchange carriers or their affiliates or Class I local telephone companies have, or have caused to be, originated, authorized, compiled, collected or edited, or in which they have a direct or indirect financial or proprietary interest." (new language italics)

Question. Should separate subsidiaries be required for the provisions of long distance services?

Answer. Assuming for purposes of this question that by "long distance services" the Committee means interLATA intrastate toll services and interstate toll services, no separate subsidiary should be required. The FCC's non-structural safeguards are sufficient to protect all engaged in the provision of this service.

Question. Should the FCC permit telephone companies to provide long distance services only if there are no legal barriers to entry in the intrastate toll market?

Answer. Assuming for purposes of this question the Committee is referring to intraLATA toll when its uses the term "intrastate toll market," Pacific Telesis Group's position is that there should be no connection between the provision of long distance services as defined above and the provision of intraLATA toll. Federal policy should govern that portion of the telecommunications industry which is interstate in nature and leave the regulation of intrastate activity to the state commissions.

Question. Should S. 2565 be amended to place other conditions on the entry of local telephone companies into the long distance market?

Answer. No. The FCC is capable of assessing the specific needs for any necessary safeguards in the provisions of long distance services by any of the participants in the field.

Question. Should a distinction be made between leasing versus ownership of long distance facilities?

Answer. No. From the perspective of an RHC being able to discriminate in favor of its own facilities or those it has leased, once equal access has been achieved this distinction will be moot.

Question. Should S. 2565 be amended with regard to the GTE consent decree? For example, should the FCC be directed to implement regulatory safeguards unique to the General Telephone Operating Companies? If son, what safeguards are needed?

Answer. Pacific Telesis has no response to this question.

Question. What is the appropriate level of fines and forfeitures?

Answer. The FCC is currently empowered to levy fines and forfeitures to a sufficient degree to carry out is mandate.

Question. What should be the role of the state regulatory bodies with regard to the lifting of existing line of business restrictions?

Answer. We do not believe Congress should affect existing state regulatory authority in this legislation. The legitimate role of the state regulatory bodies in overseeing the evolution of telecommunications policy within their respective states is set forth in the Communications Act of 1934 and should not be changed through this legislation.

Question. Should a Federal-State Joint Board be convened to set accounting or other standards to protect ratepayers and safeguard competition?

Answer. No. The FCC comment procedure allows any interested party to participate in an FCC proceeding. That procedure already allows the states to comment if they choose. The creation of another level of regulation through a joint board would only slow down a process which all agree is too time consuming now.

Question. What continuing authority would the Justice Department and the Federal Trade Commission have to police anticompetitive conduct? How effective would policing by these agencies be?

Answer. Neither would lose any of their authority under the antitrust laws. Thee is no reason to believe that these agencies would be any less effective in the future than they have been historically.

Question. What services are not now provided that would be provided if Pacific Telesis Group did not face the line-of-business restrictions?

Answer. While the specific types of information services which could be made more widely available are discussed in more detail in our written testimony filed with the Committee, the following are three examples that illustrate the value of lifting the line-up-business restrictions:

Voice mail technology, once it is widely available to residential customers through the network could serve schools across the country. Schools would have the ability to leave a message for parents, or simultaneously to groups of parents, regarding school activities, schedules and attendance. Parents could respond at any time of day or night through the same voice mail system;

Advanced technologies which convert speech into text and vice versa, when combined with storing and forwarding, could provide persons with speech or hearing disabilities with a service which would greatly expand their ability to communicate with all other telephone subscribers without special telecommunications devices for the deaf (TDD). With sophisticated processing in the network, voice communications with the hearing impaired could be put in visual form, while the hearing impaired could have their communications rendered into voice form. Similarly, with sophisticated network processing, the blind could communicate with the sighted by changing the form of communications between the two parties. For instance, the ability to convert text into braille or voice could be enhanced if teletypewriters and telebraille devices could be connected to an intelligent network which provided storage and forwarding;

an intelligent network providing information storage and retrieval and data processing could become an "electronic county agent". Farmers could obtain immediate access to data on crops, disease control, productivity enhancements and other concerns. Such information access could be provided directly through the telephone, without purchasing additional equipment, using voice storage and retrieval in the network.

Question. Would local rates go down if the restrictions were lifted?

Answer. Whether local rates would go down depends on many factors beyond the lifting of restrictions. The offering of information services through the network would help reduce the upward pressure on rates by increasing usage of the network. This increased usage would distribute the recovery of fixed costs over a wider range of services. Additional ways in which removal of the information services restriction could provide rate support for basic local telephone services are discussed in our comments to the Committee filed on July 2, 1986. Further, as discussed in question 3, infra, the network-based services themselves could directly support local rates.

Pacific Bell and Nevada Bell as committed to providing affordable residential service. In May of this year Pacific Bell filed with the California Public Utilities Commission a proposal for a "New Regulatory Framework" in California. In that filing the Company basically promised to cap residential access rates at proposed levels through 1989 with only moderate increases through 1995. Allowing Pacfic Bell to offer information services would further strengthen this financial and service commitment to our customers.

Question. Would Pacific Telesis Group use revenues from competitive businesses to cross-subsidize local telephone rates, to help keep rates down?

Answer. Pacific Bell has recommended that regulators be allowed to use proceeds from its profitable network-based information services to help support rates for local service, and Neveda Bell has endorsed a similar position. Pacific Telesis Group would not use the revenues from its unregulated subsidiaries to subsidize local rates.

Question. Some have argued that the Bell Companies are in a rush to diversify and that they are more interested in becoming conglomerates than in providing good, low cost local telephone service. Would you care to comment on that?

Answer. This argument is simply incorrect. Pacific Telesis Group recognizes that remaining solely a provider of basic telephone service will not allow us to develop the skills and services necessary to remain a competitive provider of telecommunications products and services. Diversification into other lines of business is our response to changes in operating environment over which we have little, if any, control. At the same time, Pacific Bell and Nevada Bell are committed to the continued provisions of universally available telephone service at reasonable rates. Both internal and extenal service indicators show that we continue to provide high-quality telephone service at reasonable rates.

The monitoring of Pacific Bell's and Nevada Bell's service performance is conducted through customer surveys by independent research firms, monthly questionnaires, internal measurements and customer appeals filed with the appropriate state regulatory bodies. Each method of monitoring service performance has independently confirmed that high-quality service is being provided.

The California Public Utilities Commission (CPUC) and the Public Service Commission of Nevada (PSCN) provide ongoing oversight of provision of service by Pacific Bell and Nevada Bell. Again, in its "New Regulatory Framework" filings with the CPUC, Pacific Bell is on record as supporting the continued provision of reasonably priced residential access service.

Pacific Bell currently has some of the lowest rates in the nation and charges an average flat rate of only $8.25 a month per residential customer, exclusive of the FCC subscriber line charge, for local service. For a basic monthly rate of $11.25, 82% of Nevada Bell's residence customers benefit from one of the nation's largest local dialing areas—approximately 870 square miles.

Further, both Pacific Bell and Nevada Bell provide some form of "lifeline" service for their low-income customers. In fact, Pacific Bell and Nevada Bell have offered this type of service since 1968. In California, this means that qualified subscribers can receive telephone service for as little as $1.48 per month.

At the time of divestiture the California legislature was concerned with the potential drop-off of customers that could result from increased rates. In response to that concern, and with the support of Pacific Bell, the Legislature passed the Moore Universal Service Act. That Act instructed the California Public Utilities Commission to ensure that the state's low-income residents, and others, were able to obtain residential access service at rates affordable to them. Pacific Bell cooperated fully with the Legislature and the Commission in the creation of the lifeline program and, in fact, has recommended expansion of it.

In 1984 Nevada Bell proposed a restructuring of its lifeline program. Since that time Nevada Bell has worked with the PSCN staff, the state's Consumer Advocate and the Division of Aging Services to refine the proposal. The PSCN is expected to issue an order based on the recommendations of those groups shortly.

Question. Is there a need to act quickly to lift the line-of-business restrictions?

Answer. Yes. Timely action is needed to allow Pacific Telesis the opportunity to begin bringing the benefits of the Information Age to consumers in California and Nevada as soon as possible. In addition, the increased usage of the network will result in reduced upward pressure on local telephone rates, as discussed in response to question 2 *supra.* This effect should not be delayed.

Speedy lifting of the information services restrictions will also allow the public telecommunications network to be used to increase the efficiency of U.S. companies and industries so that they can compete more effectively in domestic and world markets. Many other nations, including our major trade rivals, are striving to fully develop the intelligence in their networks, in order to expand the competitive advantage of their industries. If the MFJ continues to block our network development, the U.S. will fall further behind. If, however, network development is set free, we strongly believe that America's network will outpace all others, and that benefits will flow to our entire nation.

Question. Does the FCC have adequate jurisdiction over the RBOCs to develop accounting safeguards to prevent cross-subsidization between regulated and new unregulated ventures? In other words, can the FCC oversee potential cross-subsidy between local or intrastate services and new businesses?

Answer. The current proceedings before the FCC in its Computer Inquiry III docket, Joint Costs docket, and related matters are more than adequate to ensure protection against cross-subsidies when the relationships involve interstate services.

State commissions have adequate authority to oversee local and intrastate services and prevent cross subsidies. Pacific Telesis Group addresses the specifics of the safeguards proposed for the FCC in its response to Senator Danforth's questions connected with his proposed amendments which were issued on August 28, 1986, and question 7 *infra*, addresses specific intrastate issues.

Question. Specifically, what control over local exchange, intrastate long distance, Yellow Pages, information services or manufacturing does the FCC have now and what control should they be given?

Answer. The FCC has authority over certain aspects of local exchange and intrastate services. This authority is derived from its general authority in the Communications Act over interstate services. For instance, the FCC has authority over local exchange access services used to originate or terminate interstate calls, and both Federal and state regulators are involved in separating costs between intrastate and interstate jurisdictions. Pacific Bell's Yellow Pages is regulated by neither the FCC nor the state. However, the CPUC does consider Yellow Pages' revenues and expenses in establishing Pacific Bell's rates. The CPUC also scrutinizes the parent-subsidiary relationship between Pacific Bell and Pacific Bell Directory.

RBOC provision of information services is barred by the MFJ. However, the FCC has been exercising authority over enhanced services (most of which are considered to be information services) and has been establishing safeguards in the Computer Inquiry III and related proceedings. the FCC's relationship to manufacturing has involved protecting customers of regulated entities by ensuring proper dealings between such entities and manufacturers and setting standards for equipment which is manufactured for connection to the network.

The FCC should not be granted additional authority over local exchange, intrastate long distance services, Yellow Pages, information services or maufacturing. The balance of regualtion between the FCC and the states as set forth in the Communications Act of 1934 continues to be appropriate.

The source of concern in national telecommunications policy today is not the lack of jurisdiction in regulatory agencies, but rather the inconsistencies and delays which result from a redundant judicial layer of "regulation" on top of existing mechanisms. The MFJ restrictions have been superimposed on the regulatory structures established by Congress and state legislatures without expressed legislative intent or oversight.

Information services and manufacturing should be regulated only to the extent that they are network-based or interact directly with traditional, regulated services. The existing statutory jurisdiction of the FCC over interstate services and that of the states over local exchange and intrastate toll services is sufficient to do this. Their ability to scrutinize the costs of providing interstate services, and to audit the regulated entities data and systems, ensures that ratepayers would not subsidize information services or manufacturing activities.

Question. Is it possible to require the states to develop regulatory mechanisms to protect ratepayers in veiw of the lack of jurisdiction the FCC has in these areas? How?

Answer. Pacific Telesis Group does not believe that such provisions are needed. Our experience is that state regulators perform excellently in protecting ratepayers. if such provisions were drawn in such a way as to interfere with the functioning of regulators in California and Nevada, then the provisions would be ill-advised.

The state regulatory bodies of California and Nevada currently exercise their jurisdiction over the intrastate activities of Pacific Bell and Nevada Bell. these regulatory bodies have sufficient authority to protect ratepayers' interests, and have an excellent record in doing so. Pacific Telesis Group addresses the current safeguards for ratepayers in California in its reponses to Senator Danforth's questions connected with his proposed amendments which were issued on August 28, 1986.

Question. What guarantees do ratepayers have that they will not be funding all kinds of high technology equipment in the local telephone network for information services that they don't need or want?

Answer. Both the California Public Utilities Commission and the Nevada Public Service Commission review decisions on capital improvement of the network and ensure that ratepayers are protected. In public hearings, extensive testimony and studies are filed and witnesses are subject to multiple cross-examination. These, and other regulatory requirements, including accounting rules and extensive audits, protect all ratepayers interests. Thus, any network expenses which are not found to benefit the ratepayers would not be charged to them.

Pacific Telesis Group believes that capital improvement of the public telecommunications network benefits all ratepayers. Traditional services can be provided more efficiently if advanced technology is prudently introduced into the network.

Question. the antitrust case against the Bell System can be regarded as a result of regulatory failure. The FCC was unable to prevent the Bell System from engaging in anticompetitive behavior. Would the FCC be able to prevent anticompetitive behavior if the line of-business restrictions were lifted?

Answer. Yes. Existing and proposed accounting, cost allocation, and network access requirements will prevent any cross-subsidization of discriminatory behavior. A brief review of the basis for the decress which broke up the former Bell System and of changes in the telecommunications industry since divestiture reveals that past problems in the industry should not be used as an excuse to prevent RBOCs from entering new businesses. The antitrust case was more limited in scope than is often recognized. There are two general types of possible anticompetitive behavior: cross-subsidization and discrimination. Although the Department of Justice (DOJ) alleged various acts of discrimination by AT&T, it found no empirical evidence of cross-subsidy. (DOJ Discussion Paper EAG 86-5, 1986, Dr. Timothy J. Brennan at pp. 36-38). In addition, the DOJ's case leading to the MFJ did not even address information services. (524 F. Sup 1246.) Thus, this prohibition on the RBOCs, which was agreed to by AT&T and the DOJ, was not based on evidence or related to the DOJ's allegations of discriminatory behavior.

The Court agreed to the prohibition based on general concerns that the information services business was an "infant industry" and that the RBOCs local exchange services constituted a "bottleneck" which RBOCs could use to discriminate against information services competitors. Circumstances have changed considerably since that time.

The information services industry has become very competitive as large corporations such as AT&T and IBM, which definitely are not "infant", have rapidly expanded their reach into the information services industry by forming alliances with other corporations. Further, since divestiture a variety of means of bypassing the local exchanges have been developed, undermining the "bottleneck" justification for the restriction. any attempt by an RBOC to discriminate in the offering of its local exchange services would encourage increased use of such bypass capabilities by information services competitors. These changes in the information services and local exchange markets are more fully discussed in Pacific Telesis Group's July 2, 1986, comments filed with the Committee.

Circumstances have also changed since divestiture with regard to the manufacturing and interexchange services line of business restrictions. Prior to divestiture, AT&T produced the vast majority of telecommunications equipment used by U.S. telephone companies and provided almost all domestic long distance service. As a result of divestiture and FCC actions, the U.S. market has become wide open to foreign and domestic manufacturers. At the same time, with the development of equal access, interexchange competition has rapidly increased. If the RBOCs entered the manufacturing and interexchange businesses, they would be new to the businesses and would face this stiff competition, including that from AT&T itself.

These competitive forces which have developed since divestiture would work to prevent anticompetitive behavior by the RBOCs. Another major change since divestiture has been the development by the FCC and states of safeguards for ratepayers and competition to be applied as RBOCs enter new businesses. These safeguards are described by Pacific Telesis Group in its response to Senator Danforth's questions connected with his proposed amendments which were issued on August 28, 1986. The independent but similarly situated RBOCs, give regulators the ability to make useful comparisons in developing safeguards. Such comparisons were not possible in the unified Bell System prior to the MFJ.

Whatever original justification there might have been for the Court to retain jurisdiction over the line-of-business restrictions for a time after divestiture, the development of competitive forces, together with experience with competitive markets which has been acquired by regulators during the ensuing years, mandate transferring that jurisdiction back to regulators.

Question. Have the Bell companies satisfied the equal access requirements of the AT&T divestiture decree?

Answer. Pacific Bell and Nevada Bell have satisfied the equal access requirements of the AT&T divestiture decree. Pacific Telesis Group can only speak for its regulated subsidiaries, Pacific Bell and Nevada Bell. Conversion to equal access is an ongoing process and Pacific Telesis Group's record has been excellent.

After divestiture, Pacific Telesis Group filed its plan, which was approved by the Department of Justice, for the provision of equal exchange access. The plan set a date of September 1, 1986, for the conversion to equal access of all conforming end offices. Prior to September 1, 1986, Pacific Bell and Nevada Bell converted all but one of such offices. (Nevada Bell received a waiver for one office due to the unavailability of necessary switching equipment.)

The MFJ allows additional time to convert non-conforming end offices. The exact requirements of the MFJ in this area are in litigation.

Pacific Telesis Group is committed to full compliance with the remaining equal access requirements. The FCC is the appropriate body to ensure continuing surveillance and full, long-term compliance with these requirements.

The CHAIRMAN. Gentlemen, thank you very much.

Let me ask Mr. Kimmelman, Mr. Fischer, and Mr. Martz, about line-of-business restrictions which are now imposed against the Bell Operating Companies. They would like those restrictions lifted. Is the lifting of line-of-business restrictions inherently noncompetitive to the point that there is no way to restore fairness of competition?

Is it from your standpoint necessary to preclude the operating companies from getting into manufacturing or information services for long distance in order to have competition in these areas? Or, instead, is it possible to let them get into these businesses and maintain some sort of a rein on them so that they do not expand their monopoly to the point where they are favoring themselves and shutting out other people?

Mr. KIMMELMAN. I would say it is really a question of time as to whether it is inherently anticompetitive and inherently dangerous to ratepayers. At this point in time, we have not seen regulatory tools that can prevent the incentives to cross-subsidize. We need to develop those tools, I believe, before these line-of-business restrictions are lifted.

Work is going on at the FCC and it is going on in the States, but I think technology has outstripped regulation. So I do not believe it is inherently going to be impossible to prevent subsidization or inherently impossible to allow competition that would be fair. I believe it is too soon.

The CHAIRMAN. Mr. Fischer?

Mr. FISCHER. I think there are probably a wide variety of opinions among State regulators on that particular question. I think all regulators would agree that it will be important that we establish direct safeguards regarding cross-subsidization, cost accounting, some of the things the FCC is currently looking at before we do take away those line-of-business restrictions.

I think some regulators believe it would be important for the Bell Operating Companies to get into more of the high tech areas. Others feel that the problems of anticompetitive activity that has been widely discussed today are certainly real and need to be addressed.

I think the safeguards would be the most important part, if we go to a middle ground.

The CHAIRMAN. Do you think those safeguards could be developed?

Mr. FISCHER. I personally think that we can move a long way toward developing safeguards.

Other of my other colleagues would probably have a different opinion, but I think some of the safeguards you have included in your proposal and some of the ones that some of the Congressmen on the House side have suggested would certainly be a big step forward in that process.

The CHAIRMAN. Mr. Martz?

Mr. MARTZ. Mr. Chairman, there is almost a myth that somehow there is this vast cadre of services that aren't being offered to the consumer and only the BOCs are capable of doing it.

The CHAIRMAN. No, I do not think that that is correct. I think the question is, generally speaking as a country we are better off if more people are able to get into more areas, and obviously these are some very strong companies. They have done very well. They are doing very well. We can assume that if they get into a new area, they would do so very capably. Generally we want to expand competition and make it possible for businesses to get into areas and to take leadership roles in different areas.

The issue here is, is it so inherently noncompetitive to get the Bell Operating Companies into these various businesses that we should not allow them in under any circumstances. Or instead should we say, "Well, yes, you can go in under the following circumstances." Or "You can go in, but subject to the following powers of the FCC."

Mr. MARTZ. We have proposed basically two tests. One is a monoply position in the marketplace. I think the key is in providing any kind of a service, whether or not the telephone company which is in control of the monopoly facilities has any interest in or control over what passes through those facilities.

And I think realistically, if they do not have a monopoly position in that market, they do not have a monopoly control over the facility, there are alternative means, then I think you have the secondary area of concerns about safeguards because they have a tremendous care of technical market, capital, and consumer information which has been developed from the monopoly position; and I think there still would be a need for safeguards that they could not use that dominant position and act anticompetitively.

The CHAIRMAN. Mr. Stowe, should we be concerned that if the Bell Operating Companies get into manufacturing equipment, information service or, long distance, they will use their monopoly position to benefit themselves at the expense of people who would otherwise be competitors? Is that a valid concern that has been expressed, or should we just say, "Well, do whatever you like"?

Mr. STOWE. Mr. Chairman, our position has been and continues to be that it is in the public interest to have the Bell Operating Companies in these lines of business. We also assume at the same time that there are going to be certain safeguards and certain procedures that will be followed that will give assurance that the strong local position is not going to be used unfairly in competition.

Now if you take those two together and you——

The CHAIRMAN. Do you think such safeguards would be workable? In other words, taking a specific example, let's suppose that your company were to get into the business of manufacturing equipment. Do you think that other manufacturers would be able to compete fairly for your own business?

Mr. **Stowe**. Well, if you took the example of manufacturing, this would be an entirely new line of business. It would be something in fact that the operating company is getting into, is not already within the scope of their operations. It could be much easier to monitor than a lot of activities. In the past there was a big concern that you could not see inside AT&T because all of these things were already going on.

The **Chairman**. Could it be done as a practical matter? Or does it follow as the night the day that the businesses would prefer to do business with themselves?

Mr. **Stowe**. Well, I have no doubt that if the condition for getting into a new line of business were an instruction from the Congress and the FCC that you had to follow certain safeguards and separations that were developed by the Government, that every businessman would in fact have an equally strong motivation to follow those rules.

The **Chairman**. Do you think that it is possible to develop such rules, Mr. Fischer?

Mr. **Fischer**. I know the States would like to be involved in the process, if that is undertaken. We believe that the Federal-State joint board proposal would be the way to proceed.

The **Chairman**. Do you think it is possible to do it, though? I mean, let us assume that the brightest people around got to work on trying to develop safeguards. Is it possible to do it or is it just really impossible? Whenever you can do business with yourself, you do it to your advantage.

Mr. **Fischer**. I believe it would certainly not be an easy process. There are a lot of difficult problems to address, but I am an optimist and believe that we could develop safeguards, if that was the will of the Congress.

The **Chairman**. What do you think, Mr. Kimmelman?

Mr. **Kimmelman**. I think it is possible. I think it may be very costly. I think it may be very costly in terms of considerable regulation in order to make it happen. I think it may be even more costly in terms of dollars, in terms of putting equipment in, that eliminates incentives to discriminate. I think those issues have to be fleshed out. I don't think we know enough now to make a determination.

The **Chairman**. Mr. Martz, do you have any further comments?

Mr. **Martz**. I certainly think it would be possible, but I would agree with what was just said, that there would be a tremendous cost involved. But given the right kinds of considerations for developing safeguards and the right kinds of focus on the congressional side, it would be possible to develop safeguards. But it would be very difficult, unless you were able to eliminate the monopoly control question.

The Chairman. Gentlemen, thank you very much.

[Whereupon, at 11:51 a.m., the hearing was adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

OFFICE OF THE CONSUMERS' COUNSEL,
Columbus, OH, July 2, 1986.

Hon. JACK DANFORTH,
Senate Commerce Committee,
Washington, DC.

DEAR SENATOR DANFORTH: Pursuant to your request for comments on the propriety of the line-of-business restrictions on the Bell Operating Companies (BOCs), the Office of the Consumers' Counsel, State of Ohio (OCCO), submits these comments. OCCO represents the interests of Ohio's residential utility consumers, by authority of the Ohio Legislature.

We are very concerned with the prospect of local exchange companies (LECs), including BOCs, endeavoring to become much more than providers of local service. Apparently, the trend among LEC managers is to seek entry into all manner of competitive and nonregulated (or deregulated) enterprises. We fear that the interests of plain old telephone service (POTS) customers have been relegated to a back seat in the face of the BOCs' concerted efforts to expand their lines of business.

In this context, we are concerned that the BOCs, in particular, and LECs, in general, will abuse their captive, price-inelastic customer base (i.e., local customers) to enhance their positions in other enterprises. A cross-subsidy from residential consumers is one untoward result. This inequity is compounded, if not driven, by what we believe to be a mistaken objective of the BOCs and LECs, which is service to technology and not the consumer. It is worth reminding the regulated industry and some regulators that our society is *consumer-driven*—not technology-driven.

Unfortunately, if legislators and regulators accede to the BOCs and LECs' requests (which some have, in varying degree), consumers will be paying for all manner of state-of-the-art equipment which they do not need nor want for their service. This is bad enough with respect to equipment that is at least providing local service, albeit gold-plated. Worse is that consumers will also be paying, through cross-subsidies, for the BOCs and LECs' endeavors *not* in local service, but directed toward various competitive or nonregulated enterprises.

By way of example, OCCO will relate an incident from the recent Ohio rate case of Cincinnati Bell Telephone (CBT), before the Ohio Public Utilities Commission. PUCO Case No. 84-1272-TP-AIR, Order (December 17, 1985). (Cincinnati Bell was one of two BOCs not wholly owned by AT&T.) During our investigation in that case, we discovered the following reference from an interview with Cincinnati Bell's President, appearing in Cincinnati Bell Magazine:

"In the short run, *CBT might feel the crunch as the subsidiaries grow.* Some of CBT's best people are moving into positions in the new entities. "It's going to happen because the telephone company has the size and diversity to offer the best development for managers," [President] Sullivan pointed out. "But fortunately we have a strong cadre of "best" people.""

Soller, *"It's All In The Family."* Cincinnati Bell Magazine, June 1984, at 7 (emphasis added).

This really says what we fear is happening in many BOCs and LECs, but which few, if any, will admit—that local service will be used to enhance other LEC enterprises. Now, how in the world will even the best state regulators be able to account for this "crunch?" Certainly, Cincinnati Bell would not admit to any ratemaking adjustments in its Ohio rate case. As for Federal regulation, we believe that the FCC's pro-competitive ideology has the effect of encouraging such cross-subsidies.

For these reasons, the surest way to prevent cross-subsidies is to restrict the BOCs and LECs' lines of business. If restrictions are lifted, then legislators and regulators' efforts to protect local exchange customers from cross-subsidies should include what is called an imputed royalty in New York or an affiliate payment in California. These ratemaking adjustments operate to increase an LEC's revenues to compensate local customers for certain difficult-to-quantify, but extant, cross-subsidies flowing from regulated operations to nonregulated operations. The California Public Utilities Commission recently ordered an affiliate payment for San Diego Gas & Electric Company.

"We find that SDO and its subsidiaries may receive a number of potential benefits from their affiliation with SDG&E. Some benefits may give SDG&E affiliates an initial advantage over competitors. SDG&E has name recognition; it is a large, well established utility which has gained the confidence of the business community. This may provide affiliates with improved access to financing.

"Other potential benefits may involve access to and use of utility expertise and resources. These assets, some of them intangible, were developed with ratepayers' support. If the utility is not compensated, these benefits to affiliates represent a cross-subsidy from utility ratepayers. *We believe there will exist, in spite of all preventive measures, certain cross-subsidies that are not identified or adequately measured.*

"In addition to any benefits of association or access, we find that the creation of SDO and SDG&E's affiliates may impose costs on utility ratepayers that are difficult to quantify. We recognize in theory that a holding company is intended to better insulate the utility form the impact of risky affiliate ventures. However, costs imposed on utility ratepayers may include the increased probability of a "brain drain" of employees and managers from the utility and the diversion of management attention away from utility operations. The utility may also experience increased risk resulting from the higher-risk affiliate ventures, although the holding company structure in part shields the utility from the effects of affiliate riskiness.

"*Because of these benefits, costs, and unidentified cross-subsidies, we believe SDG&E's ratepayers should be compensated by way of a payment from SDO and its subsidiaries to the utility, which will be recognized in SDG&E's utilty rates.* The amount of payment from each affiliate will be based on a number of factors, to be established following further hearings. . . ."

San Diego Gas & Electric Co., Application 85-06-003, Decision 86-03-090, p. 48-49 (April 2, 1986) (emphasis added).

The New York Public Service Commission currently is considering the recommendation of its administrative law judge in favor of a royalty adjustment to compensate Rochester Telephone's local customers for cross-subsidies. *Rochester Telephone Corp.*, Case No. 28959, Recommended Decision (August 13, 1985). While the California and New York adjustments were considered in the context of structurally separate operations, the adjustments are even more appropriate where nonregulated and regulated operations are consolidated within one company.

To conclude, the primary consideration here should be the public interest. In the excitement of new technology and new business, we should not lose sight of the fact that approximately three-quarters (or more) of the BOCs' local customers are plain old telephone service residential customers. While we do not advocate holding strictly with yesteryear's plain old technology, we nonetheless believe that these local customers increasingly are being asked to pay for considerably more than they need for use for lcoal telephone service. For these reasons, legislators and regulators should draw the line on lines of business to either maintain the restrictions or, as a secondary alternative, adopt anti-cross-subsidy measures including a royalty-type adjustment.

Sincerely,

BRUCE J. WESTON,
Associate Consumers' Counsel.

Attachments.[1]

STATE OF MICHIGAN,
DEPARTMENT OF COMMERCE,
PUBLIC SERVICE COMMISSION,
Lansing, MI, September 11, 1986.

Senator JOHN C. DANFORTH,
Chairman, Senate Committee on Commerce, Science and Transportation, Washington, DC.

DEAR SENATOR DANFORTH: The Michigan Public Service Commission supports your efforts to address the entry of the Bell Operating Companies (BOCs) into competitive enterprises and lines of business currently prohibited by the Federal Communications Commission (FCC) or the Federal District Court. These issues currently are being addressed in several pieces of legislation—S. 2362, H.R. 3800, as well as this bill S. 2565.

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[1] The attachments were not reproducible.

The Michigan Public Service commission respectfully submits for the record the following comments:

If the responsibility for administering the Modified Final Judgment (MFJ) is transferred from the Department of Justice to the FCC by enactment of S. 2565, this legislation should be amended to address concerns best expressed by a resolution adopted by the National Assocation of Regulatory Utility Commissioners (NARUC) on July 30, 1986. The resolution said, in part:

"Whereas, The National Association of Regulatory Utility Commissioners' (NARUC) primary concern is to assure that the Bell Operating Companies continue to provide to the American people quality, universal telephone service at the lowest reasonable cost; and

"Whereas, A number of bills have been introduced in the 99th U.S. Congress to modify the MFJ; now therefore, be it

"Resolved, In order to safequard ratepayers, the following principles must be incorporated into any legislation:

"1. Any telecommunications legislation must expressly retain state jurisdiction under Section 152(b) of the Communications Act of 1934 (47 USC);

"2. On matters affecting issues arising from common federal and state jurisdiction, referral shall be made to a federal-state joint board consisting of all five FCC commissioners and four state commissioners, who would make a final administrative decision, subject to federal judicial review;

"3. Any legislation modifying the MFJ must assure that universal service is maintained, that ratepayers for regulated services are insulated from any additional risk from the competitive market, and impose adequate safeguards to prevent cross-subsidization; and

"4. Appropriate funding and resources be provided to assure proper implementation and monitoring of these safeguards."

The Michigan Public Service Commission agrees with the purpose of the legislation in transferring administration of the consent decrees to the FCC, but we believe the legislation should include some directives for FCC administration. The transfer of administration of the consent decrees should be neutral as it affects jurisdictional authority; that is, the federal and state regulators should be given no more nor less power than currently is granted under the Communications Act and as interpreted by the courts. The proposed bill should be amended to specifically state this neutrality.

The proposed bill will shift the power from the courts to the FCC which will give the FCC more power over the states than it currently has. This, in turn, would give the FCC authority over local exchange areas and intrastate competition as these areas, for the BOCs, are now governed by the consent decree. We are opposed to provisions that would give the FCC more authority over the states.

ROLE OF STATE REGULATORS

We recommend that any legislation require that state and federal regulators work together through an administratively final Federal-State Joint Board mechanism to develop criteria to be used to determine whether the MFJ restrictions are necessary. Uniform general criteria may not be possible to develop that would apply to all companies or circumstances, but, perhaps, different criteria would need to be developed for various applications.

We further recommend that the proposed legislation proscribe that state and federal regulators work together though the Federal-State Joint Board mechanism to develop proper safeguards. The FCC and state regulators have engaged in a number of proceedings to address the appropriate safeguards that should accompany any entry of the BOCs and other local exchange carriers into currently prohibited areas. State regulators currently form the only regulatory bodies that have audited most of the exchange carriers in this country and, on a day-to-day basis, administered the current accounting rules developed by the FCC and state commissions. The FCC's ultimate goal and the goal of state regulators is nearly the same: to ensure that certain classes of customers do not end up subsidizing various competitive services, and that competitive services pay their fair share of joint and common costs. (See Michigan's Comments to the FCC in CC Docket 86-111, dated June 30, 1986, for further details on accounting structure.) Appropriate funding and resources must be provided to assure proper implementation and monitoring of these safeguards.

This federal-state cooperative effort to establish national standards will allow the states to address, on an individual basis, the geographical variations for new service offerings. The states should be given the opportunity to administer the national standards on a state level; the FCC could administer the national standards in those states not participating.

The FCC and state regulators have engaged in a number of proceedings to address the appropriate safeguards that should accompany any entry of the BOCs and other local exchange carriers into currently prohibited areas. State regulators' experience to date has indicated that this is no easy challenge, short of the prohibition of entry by the BOCs. However, it is possible, and necessary, if we want to bring these new technologies to all potential customers while keeping telecommunications service affordable to all persons.

STRUCTURAL SEPARATION REQUIREMENTS SHOULD BE LIFTED

Repealing structural separation requirements can benefit customers. The primary benefit will be reduced customer costs. The elimination of duplicative overhead costs, such as personnel and facilities, imposed upon AT&T and the BOCs through the separate subsidiary requirements, will enable them to lower many of the costs typically passed on to customers. Additionally, AT&T and the BOCs may implement new technological capabilities more quickly as add-on services to their existing networks with little or no incremental cost. This will allow for faster expansion to rural and remote areas. Also, the repeal of structural separation requirements may help bring about an end to customer confusion. Customers would be pleased to find that once again they could engage in more "one-stop shopping"—when dealing with the carrier or service provider of their choice.

Existing administrative and legal requirements are more than sufficient to safeguard against impermissible activities without the imposition of structural separation. Telephone companies already are subject to a variety of regulatory controls, at the state and federal level, which require them to account for facilities used in the provision of basic services. Carriers subject to the Communications Act already are required to maintain accounting plans in compliance with the Uniform System of Accounts. As further safeguards, the BOCs could be required to file accounting plans and submit an annual audit done by an independent accounting firm. The reasons for not removing the restrictions, which include the fear of denial of access, predatory pricing, cross-subsidization, and discrimination against competitors, can be minimized through the enforcement of the proper non-structural safeguards.

ACCOUNTING AND COST ALLOCATION

The FCC, while not intending to preempt state regulators from their proper role in regulating the state rate base, does plan to direct what it will be. The accounting procedure proposed by the FCC consists of the FCC determining the allocation of costs to the state, interstate, and unregulated services of the telephone companies. This includes the FCC unilaterally determining what portion of joint and common costs will be shared by the unregulated activities which will primarily affect state services. The Michigan Public Service Commission considers it absolutely necessary that state regulators be allowed to participate in this allocation process from the beginning, and not at the end, as proposed by the FCC. While it is necessary to formulate a nationwide policy on how these costs should be allocated, states should be given the flexibility to tailor more stringent controls, if needed, on a geographic and service-by-service basis.

The FCC asserts that leaving accounting and cost allocation procedures to state regulators has a potential for disrupting the competitive provision of telecommunications service. This simply is not the case. We have duties to protect the state customer and preserve universal service. Competition is also our goal; but the FCC's way of achieving competition is through allowing cream-skimming and open-door entry without proper concern for various long-term effects. States approach the problem in a different manner since we, like Congress, have to answer to the people in the states and are not isolated, as the FCC is, from their concerns. We are the ones left to implement this process; and it is not something that happens overnight. Again, the states are the only regulators who have audited many of the more than 1400 telephone companies and made many accounting adjustments for anti-competitive abuse or bottleneck-type prohibitions when found. We can, and will, continue in this effort, if allowed to participate, since we currently have staff trained to deal with these issues.

The concern about the state regulation of regional Bell holding companies that operate on an integrated, multistate regional basis, is no reason to allow the FCC sole authority. The FCC's resources to adequately audit these regional functions are no more or less than those of state regulators'. However, if we regulators work together in a cooperative effort, the patchwork approach to regional companies can be eliminated. The BOCs' business procedures would not be affected, since it is the regional holding company, and not the BOCs, that operate in various regions.

State regulators have the most at stake. The state regulators are charged with control of as much as 70% of the total companies' revenue requirement. If any cross-subsidies are to occur, they will likely occur within the 70% portion of the revenue requirement, not within the minority portion.

OTHER AREAS OF CONCERN

Other issues presented in the proposed amendments to S. 2565 on which the Michigan Public Service Commission would like to comment are as follows:

(1) Under Section II.B. of the amendment, the FCC should only be responsible for purely interstate new service approval while the states should be responsible for intrastate services. Any disputes over what is an intrastate or interstate service should be referred to a joint board.

(2) Under Section II.C. of the amendment, the FCC should not only consult with the Attorney General and the Secretary of Commerce, but also with the state regulators in the affected jurisdictions.

(3) Under Section III.A. of the amendment, any FCC accounting rules should apply to purely interstate service offerings while intrastate matters should remain with the state regulators. The same applies to auditing, transfer of assets, information disclosure, access/interconnection and separate subsidiaries' structure financing.

CONCLUSION

We support legislation at this time provided it is jurisdictionally neutral. The legislation should proscribe that state and federal regulators should work together through the Federal-State Joint Board mechanism to develop proper safeguards to be put into place before restrictions are modified or eliminated. The FCC has engaged in a number of proceedings to address the appropriate safeguards that should accompany any entry of the BOCs and other local exchange carriers into currently prohibited areas and the FCC should work with states to achieve these safeguards. State regulators are currently the only regulatory body that has audited most of the exchange carriers in this country and, on a day-to-day basis, administered the current accounting rules developed by the FCC and state commissions. The FCC's ultimate goal and the goal of state regulators is nearly the same; to ensure that the goal of universal telephone service is met, that certain classes of customers do not end up subsidizing various competitive services, and that competitive services pay their fair share of joint and common costs. Although the FCC is concerned with interstate customers while state regulators are concerned with local customers, a Joint Board process can balance these interests.

Respectfully submitted by:

WILLIAM E. LONG,
Chairperson.
EDWYNA G. ANDERSON,
Commissioner.
MATTHEW E. MCLOGAN,
Commissioner.

STATEMENT OF THE CENTRAL STATION ELECTRICAL PROTECTION ASSOCIATION

Thank you for your kind invitation to comment on Senator Danforth's hearing on S. 2565 and its proposed amendments. The reply of our associations is in four parts:

First, the Bell Operating Companies' (BOCs) history of fair treament of the public it serves has not been good, leading to the divestiture from AT&T. It was the failure of the FCC to regulate AT&T in the first place that caused the suit against AT&T. Therefore, we fear the placement of the BOCs under an FCC which favors the BOCs. The alarm industry needs the protection of the Courts from the BOCs.

Second, we have helped the BOCs develop an affordable and feasible use of the public switched network for providing emergency signal services (including alarms) to the public. However, the implementation of this utilization depends on the outcome of present and future negotiations between the BOCs and the alarm industry. The BOCs continue to be the provider of this service, including derived local channel. We are nearly totally dependent on the bottleneck services of the BOCs for the transmission of public emergency signals for industrial hazardous conditions, security, fire, and medical emergencies. In our response to the Huber Commission, it was stated that "[i]n the process of working with the BOCs on derived channel and line status verification, the participating alarm companies are giving the BOCs access to a wide range of proprietary information relating to their existing customers and future business plans." (See Enclosure: Response to Huber Commission, "The Alarm Industry: Its Service and Markets," page 18.)

The enclosed two diagrams depict:

(1) The most recent evolution of the use of the public switched network by the alarm industry; and

(2) The alarm industry's greatest concern, whereby the BOCs could envelop the alarm industry's responsibility and take over the substance of the alarm industry through anti-competitive conduct.

Third, we are currently protected from BOC anti-competitive conduct by the 1982 Consent Decree. Under this Decree, the BOCs are afforded an opportunity to demonstrate that their entry would not be anti-competitive by the test under Section 8C. Such tests are now conducted under Clayton Act and Sherman Act criteria.

Under S. 2565, even with its proposed amendments, the test would no longer be the criteria of the Clayton and Sherman Acts, overseen by the Courts. The proposed safeguards are insufficient to protect Information Service providers from anti-competitive conduct.

Fourth, in any final legislation that may be enacted, it must be made clear that fully adequate safeguards must be in place first, before any BOCs are allowed to enter any new business.

State of Colorado,
Department of Regulatory Agencies,
The Public Utilities Commission,
Denver, CO, September 22, 1986.

Hon. John C. Danforth,
Chairman, Committee on Commerce, Science and Transportation, Washington, DC.

Dear Senator Danforth: The Colorado Public Utilities Commission applauds the Senate's interest in telecommunications policies. The Commission, however, does not consider S. 2565, a Bill proposing the Federal Telecommunications Policy Act of 1986, an appropriate remedy to the telecommunications policy issues it addresses.

The reasons are fivefold. First, Judge Greene acceded to the divestiture in part because the Federal Communications Commission (FCC) was unable to perform its function as a regulatory agency. Second, many of the issues and policy implications will be felt at the state level, not the federal level. Third, the primary business of telephone companies should remain the provision of telecommunications services. The Bell Regional Holding Companies (RHCs) have a very poor track record in their diversification efforts. Each of the seven RHCs lost money in its nonregulated business in 1985. Fourth, one of the major problems facing state regulators is the fact that the RHCs do not fall under their jurisdiction. Fifth, transferring enforcement responsibility for complex antitrust issues to the FCC would not be appropriate because the Department of Justice (DOJ) and the Court have the expertise and proven track record to handle these issues while the FCC does not.

Judge Greene stated on several occasions that the FCC was unable to perform its regulatory function. He opined that AT&T was so large and diverse and its regulation so complex that the FCC was unable to regulate this giant adequately. This Commission agrees with Judge Greene in part. We add to Judge Greene's reasoning that the FCC was philosophically opposed to regulation and, consequently, did not have the will to regulate. The FCC also lost many of its most talented employees, which further reduced the possibility of effective regulation.

Given the history and performance of the FCC, we think it is inadvisable to saddle the agency with additional responsibilities. To carry out the responsibilities outlined in S. 2565, the agency will have to become intimately familiar with the seven RHCs and each of the operating companies. The FCC will have to examine the implications of its decisions on telecommunications users in each of the 50 states individually. The task is enormous, and we do not think that the FCC has the resources or the will to tackle the undertaking effectively.

Many of the issues involved in diversification are state, not federal, issues. Diversification will directly and indirectly affect local rates and services. For instance, the success or failure of diversification efforts will affect bond ratings and stock value of RHCs, and consequently, the rate of return required for the regulated telephone companies. Federal policy also will determine the structure of local telecommunications markets. In New York City, for example, certain markets may be competitive enough to warrant unregulated competition. In Wyoming, those same services only may be available from a single supplier, if at all. The states will be in a better position than the FCC to determine which products and services should be offered in a regulated or deregulated environment. The FCC does not have the staff, the expertise, nor the interest to evaluate the appropriate mix of goods and services that is economically feasible in each of the hundreds of market areas around the country.

The primary business of telephone companies should be the provision of telecommunications services in their certificated territories in order to keep the quality and quantity of service high, and prices of those services reasonable. Diversification threatens the primary business of telephone companies. Our fear is that dollars that should be available for investment to upgrade the quantity and quality of telephone service might, under FCC regulatory concepts, be instead invested in other areas. State commissions may have little or no control over the flow of those dollars if the FCC's penchant for deregulation and preemption of state authority continues. A further weakening of state authority may harm the local ratepayer and threaten universal service.

Additionally, the track record of the RHCs in their diversification efforts is dismal. Through the third quarter of 1985, all of the RHCs had lost money in aggregate in their nonregulated activities. U.S. WEST lost a total of $180 million, notwithstanding the profits from its very lucrative unregulated directory publishing business. The regulated telephone entities are in danger of becoming cash cows for ill-advised investments by the RHCs. As opposed to wholesale continuation of diversification, state and federal regulators should be encouraged to work together (under the terms of the Modified Final Judgment [MFJ] and Plan of Reorganization [POR] and the guidance of the Court and DOJ as to antitrust matters) to ensure that the basic exchange ratepayer retains quality service and does not support unprofitable, unregulated activities.

The diversification and other unregulated activities are a major concern of many state commissions. The RHCs are unregulated and out of the reach of many state commissions. Because RHC behavior can affect basic exchange rates and services, the inability to even gather basic information about the activities of the RHCs is of great concern to this Commission. A recent report of a National Association of Regulatory Utility Commissioners (NARUC) staff subcommittee confirms these concerns. A copy of this report entitled "Summary Report of the Regional Holding Company Investigations" is attached for your review. The RHCs have transferred services such as directory publishing to unregulated subsidiaries, and have developed contracts between their regulated and unregulated entities which disadvantage the regulated entity. In many cases, state commissions are powerless to prevent these activities which disadvantage the local ratepayer. In cases where commissions have attempted to assert jurisdiction when RHC behavior appears to disadvantage the local ratepayer, that jurisdiction is often challenged. The result is protracted litigation, during which time the RHC can behave in any manner it deems profitable.

A case in point is the transfer of directory activities from Mountain Bell to U.S. West Direct. The transfer was deemed illegal by this Commission, and that decision was challenged by Mountain Bell in court. The District Court found that this Commission does have jurisdiction. A copy of the District Court opinion on this case is attached. It provides insight into the problems faced by the Colorado Public Utilities Commission in attempting to protect ratepayers from the overreaching of the unregulated RHC. The Commission ordered Mountain Bell to recapture the assets. Mountain Bell, however, requested and received a stay of the Commission's order to return the directory publishing assets until the appeals process is completed. In the meantime, U.S. West Direct receives revenues which should go to benefit the local exchange ratepayer. Among the other uses to which these revenues have been put is the purchase of two of the largest independent producers of directories, an action which may raise antitrust concerns. Even though the directory publishing assets eventually may be returned to Mountain Bell, U.S. West Direct will have enriched itself at the expense of the Colorado jurisdiction ratepayer. In addition, it will have entrenched itself further as the dominant directory publisher through the use of ratepayer funds.

The Colorado Commission encourages Congressional interest and oversight of telecommunications policy, but we do not encourage the passage of S. 2565. We think that this bill will be to the detriment of the Colorado jurisdictional ratepayer.

Very truly yours,

Ronald L. Lehr,
Chairman.
Edythe S. Miller,
Commissioner.
Andra Schmidt,
Commissioner.

Enclosures.[1]

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[1] The enclosures were not reproducible.

ASSOCIATED TELEPHONE ANSWERING EXCHANGES, INC.,
September 23, 1986.

Hon. JOHN S. DANFORTH,
Chairman, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, DC.

DEAR SENATOR DANFORTH: Enclosed is ATAE's written testimony,[1] which we would like to have included in the official hearing record for your recent hearings on S. 2565, the Federal Telecommunications Policy Act of 1986.

As always, we appreciate this opportunity to present our views to the Congress on this important policy area.

Sincerely yours,

JOSEPH N. LASEAU,
Executive Vice President.

SEPTEMBER 22, 1986.

Sen. JOHN DANFORTH,
Senate Commerce Committee,
U.S. Congress, Washington, DC.

DEAR SENATOR DANFORTH, We have followed the hearings on S. 2565 with great interest, because the post-divestiture transition in telephone service is a rocky one for consumers and has serious implications for the public interest. As your own comments have recognized in the course of this discussion, the telephone network is not only an economic resource but a social one as well, a basic part of the infrastructure of an information-reliant society.

For those reasons, we maintain that S. 2565 would not serve the public interest. We recognize that administration of the Modified Final Judgement (MFJ) is fraught with unforeseen complexities, and we also recognize the need for a healthy procompetitive environment for telecommunications in this country. However, the solution proposed by S. 2565 would result in more problems than the current situation provides.

S. 2565, since it simply transfers administration of the MFJ to the Federal Communications Commission, effectively takes all the problems involved in the current situation and simply relocates them.

The site of relocation itself raises grave questions about the efficacy of this move, especially given the current FCC administration's recent record in policy affecting universal telephone service. The *Computer III* decision, for instance, effectively depends on the as-yet unrealized concept of Open Network Architecture to guarantee that Bell Operating Companies do not act uncompetitively. The FCC's monitoring of universal phone service has been harshly criticized by the General Accounting Office. Procedures for the role of the states in participating in telephone policy under this new arrangement are not spelled out in the bill.

Our fundamental objection to S. 2565, however, is that it intervenes decisively but not responsibly in telephone policy. If Congress is to take an active role in formation of telephone policy, it should do so with deliberation and full attention to the needs of the greatest number of citizens affected. And yet fundamental clauses to shield residential and small business users from harsh price increases, to protect ratepayers from misuse of their contribution to the telephone network, to maintain and expand universal service, and to make provision for what has come to be known as "Lifeline" service are absent from the bill.

We urge Congress to include, in any telephone legislation, the needs both of those who face higher phone rates and those who face no phone service at all. Ratepayer protection is key to any responsible Congressional action. As a recent study by the Consumer Federation of America details, excessive phone company profits have already demonstrated that need. ("Local Rate Increases in the Post-Divestiture Era: Excessive Returns to Telephone Company Capital," released Sep. 9). Higher phone prices have entailed sacrifices both in use of the telephone and in other basic needs of those on fixed or low incomes. Of equal importance is Congressional action on behalf of those who drop off or who never have been "on the network" and daily augment the phoneless society. (For information on problems in universal service today, see Comments of the United Church of Christ, Office of Communications, in FCC CC Docket 78-72, CC Docket 80-286, August 18, 1986.)

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[1] See House of Representatives Committee on Energy and Commerce printed hearing of Mar. 10, 1986.

Congress has some models for such protective clauses available to it, particularly in the ratepayer protection proposals made in August by Reps. Ron Wyden (D.-Ore.) and Al Swift (D-Wash.). Such proposals can become the platform for a wider discussion of basic public interest-oriented policy in telecommunications. It is such a discussion that is needed before Congress takes action of the magnitude suggested by S. 2565.

Sincerely,

DR. BEVERLY J. CHAIN,
Director, United Church of Christ, Office of Communication.
PAMELA GILBERT,
Staff Attorney, United States Public Interest Research Group.
LINDA LIPSEN,
Legislative Counsel, Consumers Union.
TOM TOBIN,
Field Director, Public Citizen.

NATIONAL CABLE TELEVISION ASSOCIATION,
Washington, DC, September 23, 1986.

Hon. JOHN C. DANFORTH,
Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, DC.

DEAR CHAIRMAN DANFORTH: The National Cable Television Association is pleased to submit these comments for the Committee's review of S. 2565, "The Federal Communications Policy Act of 1986," and for its consideration of the relationship between communications policy and the Modification of Final Judgment in *US* v. *AT&T*. These comments supplement our earlier statement filed with the Committee July 3, 1986.

NCTA is the principal trade association of the cable television industry and represents over 2,400 cable systems serving more than 75% of the 40 million cable homes in the United States. The Association also represents 56 cable programming services that create, package, and provide quality television programming for cable subscribers.

The appropriate role to be played by intraexchange monopoly telephone companies in the provision of electronic publishing services to the public has been debated in Congress and the courts for over 7 years. This debate has always produced the same result: telephone companies should not be allowed to own or control information transmitted over their monopoly facilities. The reason for this consistent consensus is quite simple. Fundamental First Amendment values are at stake.

This policy was first adopted by the House Commerce Committee in the 96th Congress in H.R. 3333. As you recall, Mr. Chairman, in the 97th Congress, the Senate passed S. 898, reported by this Committee, which prohibited local Bell operating companies from providing "mass media" services, which the Committee defined to include "television and radio broadcasting, pay television, and printed or electronic publications (including newspapers, periodicals, and any service or product like or similar to all or a part of the traditional function of a newspaper or periodical)." The House Commerce Committee built on the essential safeguards of S. 898 and reaffirmed its earlier policy position with a similar ban when H.R. 5158 was considered in 1982.

NCTA and the American Newspaper Publishers Association joined as intervenors to advocate this congressional policy consensus before Judge Greene in his Tunney Act proceedings on the proposed MFJ. Judge Greene agreed with this consensus and borrowed directly from House and Senate communications policy legislation in order to protect the public interest. He refused to accept the consent decree unless the parties agreed to include in it a provision imposing an electronic publishing ban on AT&T similar to that imposed on the BOC's.

The last time this issue was addressed by Congress, the appropriate role for local monopoly exchange carriers to play in the provision of information to the public was again reaffirmed as a crucial element of the Cable Communications Policy Act of 1984. This Act allows local carriers to provide transmission capacity for unaffiliated third parties to provide video programming, subject to the franchise requirements of the Act, but prohibits the common carrier itself from selecting or providing the video programming that might be offered over its facilities.

NCTA shares ANPA's position that the long-standing federal policy aimed at promoting the availability of a diversity of information sources transmitted over telephone lines should be preserved.

Nothing has occurred in the years since these policy decisions were reached that would make the risk of electronic publishing by BOC's any more acceptable today than it was. Nothing has changed, either technologically or in the marketplace, that could justify Bell operating company entry into electronic publishing over its own facilities. The same competitive considerations exist today as existed when these long-standing policy decisions were made. NCTA and ANPA agree that the same conclusion should be reached by the Committee today in its deliberations over S. 2565.

Allowing the Bell operating companies to own or control the information disseminated to the public over their monopoly intraexchange facilities would provide these companies with both the ability and incentive to engage in anticompetitive conduct. The victims of such conduct would not only be other information providers forced to rely upon the operating companies for transmission of their information, but also the public, which would lose access to information from a diversity of sources.

Mr. Chairman, you have asked for input on the circumstances which could end the electronic publishing ban on the BOC's and AT&T. NCTA does not believe that the appropriate public policy approach to this issue is to sunset the prohibition. NCTA believes that, as a general rule, public policy either does or does not make sense because of market conditions. Termination of sound public policy at some arbitrary date does little more than provide perverse incentives for anticonsumer behavior.

NCTA and ANPA agree that entry by Bell operating companies into electronic publishing should be determined by the amount of market power possessed by those companies. When distribution technologies are in place to which electronic publishers may turn as meaningful transmission alternatives to the BOC's, the prohibition would no longer be justified. Until that time, however, NCTA believes that the long-standing policy barring BOC's from electronic publishing over their monopoly intraexchange facilities should, and must, be retained.

NCTA, as always, stands ready to work with the Committee as it continues its deliberations in this important matter. We request that this statement be made a part of the record of the hearings on S. 2565.

Sincerely,

JAMES P. MOONEY,
President.

XEROX CORP.,
Stamford, CT, September 23, 1986.

Hon. JOHN C. DANFORTH,
Chairman, Committee on Commerce Science, and Transportation, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: I would like to submit, on behalf of Xerox, our comments with respect to the proposed Federal Telecommunications Policy Act of 1986 (S. 2565). We welcome the thoughtful amendments proposed in your office's August 28, 1986 press release, and your commitment, expressed during the recent hearings, to ensure meaningful Congressional guidance in any transfer to the Federal Communications Commission of authority over antitrust law issues relevant to the Modified Final Judgment and U.S. v. AT&T.

The information and telecommunications industry of the U.S. has invested substantial resources during the past six years in monitoring, analyzing and responding to changes in the structure of the industry and the rules of the marketplace, as developed or proposed by the various judicial and FCC proceedings.

Xerox has participated actively in this process. As a manufacturer of office systems that depend heavily on the viability and costs of the telecommunications network and that may compete in the future with services offered by the common carriers within that network, we are deeply interested in the outcome of these proceedings.

Our principal concern is that the U.S. domestic telecommunications industry includes authorized monopoly businesses that, if allowed to operate inappropriately, could exert unfair and anti-competitive influence in markets that are otherwise totally competitive. As we understand it, the basic thrust of S. 2565 would be to transfer administration of the AT&T divestiture decision and the MFJ from the Department of Justice to the FCC. In the absence of Congressional standards to address the concerns highlighted in your amendments, we fear that this might lead to, among other things, the subordination of unfair competition issues to other factors in evaluating potential changes to the structure of the information and telecommunications industry.

Xerox shares the concerns of others who have called for appropriate telecommunications and information services guidelines or for certain limitations on decisions to prevent any unfair advantage accruing to the divested Bell Operating Companies. In this regard, we strongly support the constructive position of the Computer and Business Equipment Manufacturers Association.

As you know, the Department of Justice's in-depth study of the telecommunications industry is nearing completion. In light of the study's findings, a Report to the Court will be submitted in January that may directly affect the need for legislation. Therefore, Xerox urges the Committee to act deliberately on this important legislation, taking the time to obtain through the Department of Justice and other studies a thorough understanding of its full implications for the U.S. economy.

Thank you for your courtesy and consideration.

Sincerely,

ROGER E. LEVIEN,
Vice President, Corporate Strategy Office.

BETHESDA, MD, *September 23, 1986.*

Hon. JACK DANFORTH,
Chairman, Senate Commerce, Science, and Transportation Committee, U.S. Senate, Washington, DC.

DEAR SENATOR DANFORTH: This letter is to provide further comments on the issues surrounding the implementation of the Modified Final Judgment (MFJ) which set the terms of the Consent Decree, concluding eight years of antitrust litigation in *U.S.* v. *AT&T.* Since my earlier comments on 3 July 1986, I have had the benefit of reading the voluminous other comments submitted to you, and I have conducted additional independent reserach on the core legislative questions as articulated by your staff.

I draw the following conclusions:

1. As surprising as it may seem, a reliable factual basis on which to make reasoned judgments as to the proper course of action has not yet been established—neither as part of this "paper hearing" nor in any other pending proceeding or forum. It appears that the so-called "Huber Report," presently being prepared under the direction of the Department of Justice for submission to the Decree Court in January 1987, promises to be the most objective compendium of relevant information yet assembled. Congress would be doing itself, and its constituents a great disservice to proceed with legislation based on incomplete information.

2. Significant legal questions arise in the form and substance of the proposed legislative initiatives presently under consideration. The most distressing issue, even if legislation were to fail in this session, is the appearance of Congress applying undue pressure upon the judicial branch in its Constitutional role of implementing justice. Further, if the pending legislation were to pass, without simultaneously revising existing antitrust doctrine, the Bell Operating Companies (BOCs) would simply inherit the legacy of the pre-divestiture AT&T—and even under "perfect behavior" on their part, the telecom market would be subjected to unwarranted uncertainies as litigations rage on. The FCC has neither the authority, the experience nor, it seems, the resources to address these impending antitrust concerns.

3. The BOCs still possess unique resources, and have evidenced a proclivity towards anticompetitive acts, even in the post-divestiture era. Control of the "essential facilities" for universal local distribution is still theirs, as is the corollary control of customer, carrier and network information. Disingenuous comments, exemplified by a Pacific Telesis executive's remarks that PacTel acquired a Dalls-based paging and cellular operation for $432 million by "saving pennies" and paying in cash, underscore the enormous capital advantage the BOCs maintain (L.A. Times, 2/15/85, p. IV-2).

4. Assertions that permitting the 7 Regional Holding Companies (RHCs) to manufacture equipment for domestic consumption would significantly improve the trade balance in telecom equipment must be viewed with considerable scepticism. The RHCs possess no unique technological know-how, save perhaps the knowledge of internal network operations, which would give them a competitive advantage to succeed against existing suppliers; indeed, if RHCs were allowed to manufacture, this network information should be provided on a non-discriminatory basis. More impor-

tantly, RHCs face higher labor costs, relative to U.S. manufacturers (and certainly foreign sources), stemming from their traditional corporate structure and labor union commitments.

5. Finally, considerable questions regarding consumer protection remain unanswered. Government-supplied statistics confirm that access to telephone service on a universal basis has steadily increased, and is growing at a pace unaffected by the massive rate-hikes of the post-divesture period. In this same period of massive rate-hikes, federal policies have required a $2 access charge per residence line (even more for businesses) to be collected by BOCs. RHC profit margins have risen in double digit fashion for the first half of 1986 as compared with last year, even while the newly launched RHC ventures show massive losses. Objective reasoning suggests that rates-of-return are far higher than they could be, and that a strong likelihood of cross-subsidization of non-regulated ventures exists. Adding weight to this concern is the fact that the federal government, by far the largest single user of all telephone services, has petitioned regulators in 32 states to hold formal inquiries into these matters.

In light of the foregoing conclusions, a more appropriate course of action for Congress to undertake may be to ensure that the proper information is publically available to assess the current status of the underlying components of the telecom policy debate. Congress could, for example, direct the GAO to audit the implementation of the CALC program to verify that monies collected are truly used to advance universal service—and not subsidize other ventures. It could also direct the OTA to conduct an assessment of the telecom equipment manufacturing market in connection with developing potential safeguards for entry and operation, if it is deemed RHC manufacturing be permitted. It could also rely upon the coorperation of the Commerce Department in the collection and analysis of statistics relating to international competitiveness, labor & productivity and trade—utilizing information derived from import and export declarations to determine what proportion of domestic demand is met by foreign sources and what share of the world market is met by U.S. suppliers.

Sincerely,

Oliver C. Dziggel.

Statement of Associated Telephone Answering Exchanges, Inc.

INTRODUCTION

Associated Telephone Answering Exchanges, Inc. (ATAE), is the trade association for the live telephone answering service and voice messaging industries. Its members are primarily small, owner managed businesses engaged in the provision of a wide range of telecommunications messaging services to the general public. These services include both the traditional, live operator handled telphone answering service (TAS), and computerized voice storage and retrieval services.

ATAE member service bureaus are, and will remain for the forseeable future, totally dependent upon the monopoly, local exchange telephone carriers (including the Bell Operating Companies), for their services and facilities necessary to conduct their businesses.

ATAE is vitally concerned with the issues addressed by the "Federal Telecommunications Policy Act," and with the maintenance of a fair, open and competitive marketplace for "enhanced" or "information" services, such as those which ATAE members provide.

We are concerned, however, that the seemingly simple, noncontroversial approach taken in this bill will, in fact, have impact and ramifications in the telecommunications market far beyond the intentions of its authors. We fear that its adoption would undermine vitally important protections against abuse by the BOCs of monopoly, bottleneck facilities which are contained in the Modified Final Judgement (MFJ) in the AT&T antitrust case.

BILL'S EFFECTS UPON THE LINE-OF-BUSINESS RESTRICTIONS

At the outset, let us state plainly that ATAE supports the line-of-business restrictions contained in the MFJ as both approprite and necessary to the continued development of an open, truly competitive telecommunications market. Our reasons for this view and a brief recital of the damages which the monopoly telephone companies can and have inflicted upon our industry were the subject of testimony made before the House Telecommunications Subcommittee in March of this year. (A copy of this testimony is included herein as an appendix).

Other parties (particularly the BOCs themselves and the Federal Communications Commission's chairman), disagree with ATAE's position on these restrictions. That is certainly appropriate. ATAE welcomes every opportunity for open and lively debate on this important and difficult policy area.

It is argued, however, that the content of telecommunications policy itself are not the subject of this bill, and, more particularly, that the legislation does not materially alter or make any judgements on the merits of the line-of-business restrictions. We respectfully disagree.

S. 2565 would direct the FCC to promulgate a set of rules which exactly duplicate the terms, conditions, and restrictions contained in the MFJ. However, once this is done, the FCC will be empowered to modify, rescind, or grant waivers to these rules, as it sees fit. Anything that the FCC expressly permits, the bill states, would not constitute a violation of the decree. In short, the FCC can unilaterally contradict and overturn any aspect of the consent decree.

A shift of authority does not necessarily mean a change in policy, to be sure, but it is certainly naive in the present situation to believe that the FCC could continue to administer the MFJ in the manner in which Judge Greene and the courts have. The major policy item which has occupied the commission for the past year has been its "Computer III" proceedings, a rulemaking which establishes the exact terms and conditions under which the BOCs, but for the existence of MFJ, might offer the types of services expressly prohibited in the line-of-business restrictions. The rules expressly waiving the MFJ prohibition on information services are already in-place, even before the FCC can "promulgate rules incorporating all of the conditions of the decree", as S. 2565 directs them to do. The issue has been prejudged. The FCC, in fully appropriate exercise of its duties, has considered and acted on the very issues embodied in the MFJ, and reached a different conclusion than the courts.

S. 2565 is not policy neutral. Its enactment would result in the immediate replacement of the MFJ's line-of-business restrictions and waiver processes with the FCC's more lenient and less antitrust-sensitive Computer III regulations. This may be an action which the Congress would want to debate; it is too far-reaching and major a reversal in telecommunications policy to be hastily accomplished under the guide of "neutral" legislation without adequate hearings on the policy itself.

CONSOLIDATION OF TELECOMMUNICATIONS POLICY MAKING

The stated intention of the legislation is to achieve a consolidation of all telecommunications policy decisions where the expertise resides: at the FCC. This view, along with the bill's intended "policy neutrality", bears closer examination as well.

If the divestiture court is, in fact, involved in telecommunications questions of a purely technical nature, some very limited and narrowly defined shift of jurisdiction over just those issues is arguable. The wholesale gutting of the MFJ in its entirety in order to relieve the courts of decision-making responsibility over a few telecommunications technicalities, however, is both illogical and dangerous.

Although the MFJ governs the major players in the telecommunications industry, is not a telecommunications decree, per se. It is an antitrust settlement. Its conditions and restrictions were not crafted because of situations unique to the telecommunications industry; rather, they were crafted to address the issue of monopoly control of bottleneck resources vital to a competitive operation. These are antitrust issues, and the expertise in dealing with antitrust enforcement (not to mention the constitutional responsibility) lies with the federal judiciary, not the FCC.

And it should be noted that the antitrust case brought against AT&T in 1974 which ultimately resulted in the MFJ was brought to trial precisely because the FCC's fully competent administration of telecommunications policy had not prevented the possibility of antitrust violations by the telephone companies. The industry structure accomplished by the MFJ is not a theoretical concept, artificially imposed upon the market by legal academics in a classroom setting far removed from the real world: it is, in fact, a negotiated settlement, agreed to by consent of the parties, which addresses a history of actual and potential anticompetitive harm occurring in the marketplace.

The antitrust case and its resulting settlement (the MFJ) were necessary because the FCC's regulatory processes alone were not able to effectively prevent, monitor, or detect the kind of anticompetitive abuses which the MFJ prevents.

What was beyond the realm of "purely" telecommunications policy administration in the 1960's and 1970's (and thus beyond effective enforcement by the FCC), remains so in the 1980's. In fact, the detection and prevention of anticompetitive abuses by the BOCs is, today, an even more formidable task than it was when the antitrust case was filed in 1974, because current FCC policy encourages the blend of competitive and monopoly activities within a single corporate entity.

Removing the antitrust courts from the picture, as S. 2565 would do, exactly recreates the situation which let to the costly AT&T antitrust action and, we fear, will lead us in the same direction again.

Neither the FCC nor the antitrust authorities alone provide an adequate framework in which to balance the complex and important issues involved in fostering the development of a fair, open and competitive telecommunications market. Both the market opening thrust of the FCC and the cautious review of the antitrust court are necessary to insure a marketplace in which both the large telephone companies and the small, independent entrepreneur have the right to succeed or fail, based upon their own performance.

THE PUBLIC INTEREST STANDARD IN TELECOMMUNICATIONS POLICY

Proponents of the approach taken by S. 2565 also argue that the current regulatory structure needs to be modified because the court reaches all MFJ decisions based solely upon an antitrust standard which is too limited in scope. Shifting the administration of the decree to the FCC, they contend, enables consideration of "the public interest" in reaching policy decisions.

The fact that the antitrust laws were enacted and the Department of Justice has been vigorously enforcing them for nearly a century in order to protect the public's interest seems too obvious to need any elaboration. However, many BOC representatives have suggested that when applied to them, the antitrust laws are in some way contrary to the public interest, and that S. 2565 will correct this ill.

It should be noted that the "public interest" basis of the antitrust laws was strongly reaffirmed by the Congress in the 1970's through its enactment of the Antitrust Procedures and Penalties Act, also known as The Tunney Act. The Tunney Act requires that extensive public notice be given, comment invited, and hearings held before a consent agreement can be entered into, specifically to insure that proposed action is "in the public's interest." While there was some question as to whether the Tunney Act should apply to the MFJ when it was proposed by the Department of Justice and AT&T in 1982, the parties agreed to apply the conditions of the Tunney Act to the MFJ. Judge Greene and his court held extensive hearings, and as a result of various public interest concerns raised in those proceedings, required substantial changes be made in the MFJ before it was entered. This has been done explicitely to insure that the public interest was served.

Shifting the jurisdiction from the court to the FCC does not insure that the public's interest will be considered in policy decisions: the public interest is at the basis of all public policy decisions, whether made by the courts or the FCC. The jurisdictional shift proposed in S. 2565, however, would mean that those areas of the public interest protected by the antitrust laws would lose in prominence and, as a result, be less vigorously enforced.

ACCOUNTABILITY

It is also argued that taking the MFJ away from the control of a single judge will restore accountability to telecommunications policy.

In fact, however, accountability has been a critical element in the courts' MFJ considerations. There is no reason to believe that this will change in the future.

The MFJ itself has been the subject of judicial appeal all the way up to the Supreme Court of the United States, where it was unanimously affirmed. Every action by the court in enforcement of the MFJ is the subject of public notice and consideration before a decision is made. Judge Greene has never excluded the comments of any interested person from the record in his consideration of waiver requests, although legal technicalities exist which could warrant limiting public involvement, if that were his desire.

Any party dissatisfied with any action by the courts has recourse to judicial appeal and to the Congress itself.

The image which some telco critics paint of Judge Greene operating in a vacuum, oblivious to the real world outside of his law books is grossly unfair and totally inaccurate. The constitutionality-based system of checks and balances insures that no individual operates without accountability to the public that he serves. The manner in which Judge Greene has conducted enforcement of the MFJ has, if anything, encouraged public involvement. BOC pleas for "accountability" appear to be pleas for a forum in which their desires are taken more into account; at the expense of the public interest with which they profess to be concerned.

CONCLUSIONS

While ATAE strongly believes that the line-of-business restrictions contained in the MFJ, as they pertain to information services, are fully justified and, in fact, necessary to the continued development of an open, competitive telecommunications market, we recognize that others disagree with this view. We have, accordingly, been vigorous participants in policy debates in this area before the FCC, the Congress, and the courts. We welcome every opportunity to argue our case: that is how policy is made.

We object to S. 2565, however, and particularly to the ill-considered haste with which it is being reviewed, because it circumvents debate of the critical issues of telecommunications policy content by ostensibly addressing only the form or process of telecommunications policy making. The bill, however, is anything but "simple" and "non-substantive" in its effects. It will, in fact, substantially change the content and nature of telecommunications policy. And it does so without directly addressing the hard issues and tough choices which are needed in this policy area. Such wholesale policy changes should not be enacted without due and deliberate consideration of those policies themselves.

S. 2565, or a similar piece of legislation, is, in our view, dangerous because it proposes to do so little when its effects will be, in fact, so profound.

STATEMENT OF BELL ATLANTIC CORP.

Today, the Bell Atlantic Corporation must look to three different federal entities to tell us what we can or cannot do in the business environment in which we operate. As you might expect, we often get a different set of rules from the Federal Communications Commission (FCC), the U.S. District Court, and the Department of Justice (DOJ); and we get an intolerable amount of confusion, duplication and squabbling.

The nation's telecommunications policy should not be implemented in this fashion. The American consumer is the loser.

Bell Atlantic has a vital interest in the development of a national, coherent telecommunications policy process. Through its $16 billion investment in local telephone plant and its 72,000 employees, the company provides local services to more than 27 million people in the mid-Atlantic region. Both the public interest and the interests of Bell Atlantic's 1.4 million shareowners—nearly 1 million of whom own fewer than 50 shares—will be served when these resources are deployed rationally to bring the greatest good to the greatest number of Americans.

The AT&T Consent Decree of 1982 effectively balkanized federal regulatory authority among three different "regulators/referees"—the FCC, the DOJ, and the Court.

Fortunately, the Senate Commerce Committee under Senator John Danforth's leadership is examining the merits of S. 2565, a bill introduced by Majority Leader Robert Dole. The Dole bill provides for one federal "regulator," returning authority to regulate the industry to the agency Congress created in 1934 to do this very job—the FCC.

Unfortunately, debate about the Dole bill too often has focused on the presumed likelihood that the FCC would allow the regional Bell holding companies, like Bell Atlantic, to offer information or long distance services or engage in manufacturing, markets currently closed to them by the Consent Decree AT&T negotiated with Justice in 1982.

There is no question that these major policy questions must be addressed, and soon. They affect foreign trade, jobs, consumer choice and the very future of telecommunications in the United States. And as Bell Atlantic stated in its written response to Senator Danforth's query last May, the company strongly believes that the AT&T Consent Decree restrictions should be lifted, now.

But Senator Dole's legislation does not attempt to answer these questions. Rather, it would vest authority for finding answers precisely where it should be—with the FCC. The Commission's actions can always receive whatever oversight the Congress deems appropriate, thereby restoring congressional control over telecommunications policymaking. The bill makes clear that Congress believes the FCC should be the federal regulator, not the Courts or the Department of Justice. In addition, Senator Dole's approach accurately reflects Congress' wish that it not become the day-to-day regulator of the telecommunications industry. In short, the Dole bill addresses the process of setting telecommunications policy.

Today's process produces disjointed policies that frequently ignore the public need. For instance, consider the very real problem of operator services. Some time ago the regional companies asked the DOJ whether their operators returning from AT&T, as provided for in the Plan of Reorganization, could handle interLATA calls for the interexchange carriers. The companies presented the DOJ with their plans for doing so; the DOJ pondered these plans for nearly two years before responding. The DOJ finally concluded that the Bell operators could handle interLATA calls, but that key aspects of the plan for doing so should be passed upon, in the first instance, by the FCC.

AT&T thereupon challenged before the Decree Court the conclusion that the Bell operators could be used to provide services to AT&T competitors. It will take additional months for the Court to resolve the operator services issue and then, depending on the outcome, the FCC will have to be consulted about the various matters the DOJ declined to address. In the meantime, tens of thousands of operators are returning to the Bell companies, but nobody knows the full extent of the services they can lawfully provide.

Equal access provides another example of our country's disjointed policy process. Both the FCC and the Decree Court have held protracted and duplicative inquiries into equal access issues, including the handling of "undesignated" long distance calls—calls for which the calling party does not specify an interexchange carrier to handle the call. The Court concluded that these calls could be handled by AT&T. The FCC reached a different conclusion—namely, that the calls should be allocated among all interexchange carriers.

In large part, these problems are compounded by the different criteria our regulators apply in responding to questions about policy. The Justice Department and the Court are guided primarily by concern for the well-being of competitors, while the FCC must consider the public's broader interest in an efficient, low-cost telecommunications system. Naturally, conflicts arise, and the industry and the public are caught in the middle.

One of the most serious flaws of the AT&T Consent Decree is that it compels the Court to base its regulation of telecommunications on a static document designed to remedy abuses allegedly committed by an institution—the Bell System—that, quite literally, no longer exists.

The Decree is, in effect, retrospectively oriented; by its very nature, it ignores the future and fails to recognize the promise implicit in telecommunications technology.

For instance, existing technology can deliver a wide range of new information services to the home and office. The local telephone network can bring these new services to the market efficiently and at a reasonable cost. The FCC is trying to allow the local companies to provide such services. But its efforts may well be negated by the Consent Decree's blanket prohibition against "information services."

Who suffers most from this jury-rig approach to policy-making? Certainly not our competitors. They favor the confusion and duplication and protection insured by the status quo. It would be surprising, indeed, if protected competitors wanted the rules changed.

Ultimately the American consumer pays the price for this lack of real competition and for the duplication and contradiction inherent in the current policy process. And, to whom can the consumer turn?

The existing policy process makes it nearly impossible to hold any one agency or official accountable. One agency or official can always blame another for snafus. Delay, uncertainty and inconsistency are the hallmarks of the system. There is no place the public or the industry can point to and say, "The buck stops here."

Placing federal regulatory authority squarely with the FCC, with congressional guidance that allows for the kind of flexibility the FCC needs to respond to technological and competitive changes in the telecommunications industry, will ensure that public as well as private interests will be better served.

The time has come for Congress to step in and re-assert its authority over national telecommunications policy. By providing for this shift of authority to the FCC, it would tap the one federal agency with the expertise and manpower to get the job done, and done under the watchful eye and direction of the people's representatives.

STATEMENT OF THE BELLSOUTH CORP.

EXECUTIVE SUMMARY

BellSouth strongly supports congressional review of the AT&T Consent Decree and elimination of the line of business restrictions that inhibit competition in the information, manufacturing and interexchange markets. Since the 1982 settlement of the government's antitrust suit against AT&T, the Consent Decree has preempted Congress as the primary architect of our Nation's telecommunications policy and has displaced the FCC as the policy implementor. It also encourages application of a narrow "antitrust" standard rather than the broad "public interest" standard as the criterion for evaluating the impact of divestiture on consumers and the Nation.

The Consent Decree's restrictions disserve the "public interest" because they discourage network integration, sharing of common costs, and economies of scale. This increased network efficiency could result in lower local rates for consumers. The longer the MFJ's restrictions are in place, the longer the public, particularly residential consumers, will have to wait for access to affordable technolgy, and the higher costs will be in terms of lost opportunities and actual costs of alternative services. The restrictions also disserve the national interest because they inhibit competition at home and abroad which adversely affects jobs, trade and technological innovation.

The MFJ's manufacturing ban has had, and will continue to have, three detrimental effects. First, it has displaced U.S.-produced equipment with low cost foreign CPE. Second, it has driven the BOCs to purchase large central office equipment from foreign suppliers because of the potential for competition between domestic vendors and the BOCs. Third, the BOCs are unable to upgrade existing central office switches to meet current and future customer needs because domestic switch vendors refuse to disclose proprietary information about software integrated into central office equipment used by the BOCs.

Our Nation's policy should have four objectives. It should: (a) preserve universal, reliable, state-of-the-art service for all customers; (b) encourage research and technological development; (c) rely increasingly on competition, not regulation; and, (d) foster the penetration of U.S. equipment manufacturers in both domestic and foreign markets; at the very least, U.S. firms and foreign companies should be accorded the same treatment in U.S. markets.

These goals should be advocated in clear policies by the Congress and implemented by the FCC using the "public interest" standard as its guide. The national interest requires Congress to create an environment that allows the BOCs to pursue policies that encourage efficient network use and serve the interests of all their customers.

I. INTRODUCTION

BellSouth strongly supports congressional review of the AT&T Consent Decree (Modification of Final Judgment or MFJ) and elimination of the line of business restrictions that inhibit competition in the information, manufacturing and interexchange markets. It also encourages application of the broad "public interest" standard to questions about Bell operating company (BOC) and regional holding company (RHC) participation in these restricted markets.

Almost five years have passed since the government settled its antitrust suit against AT&T; January 1, 1987 will mark the third anniversary of divestiture of the operating companies from AT&T and imposition of the MFJ's line of business restrictions. The telecommunications industry's regulatory and business climates have changed dramatically since these events were set in motion and, therefore, it is appropriate that Congress review their effects on residential and business consumers, and on the industry's competitiveness, to determine whether U.S. telecommunications policy has kept pace with change and still serves the national interest.

The most significant difference between the current telecommunications environment versus the environment in 1982 is the degree to which competition is present. The long distance market today is accessible to all carriers as a result of equal access implementation. In addition, AT&T's toll rate reductions are jointly responsible for increased competition and usage, as well as lower rates for many long distance customers. With the implementation of comparably efficient interconnection and open network architecture, the network also will be more accessible to all information providers. Finally, the FCC's plan to separate costs of regulated telephone service from the costs of non-regulated service will prevent cross-subsidization of telephone company non-regulated ventures by its regulated operations, thereby assuring just and reasonable charges to its ratepayers.

The greatest change, however, has been the entry of foreign firms in U.S. equipment markets. Foreign suppliers correctly viewed divestiture as an invitation to invade the U.S. and their progress has been swift and dramatic. In 1982, when settlement first was announced, the U.S. telecommunications equipment industry experienced a trade surplus of $203 million. By 1985, that figure had plummeted to a deficit of $1,176 million and the trend promises to continue in the same direction for the foreseeable future.

The trade imbalance has at least two important components—increasing dependence on foreign suppliers to fill U.S. needs and the failure of U.S. manufacturers to achieve comparable success abroad; both are directly tied to the MFJ's manufacturing ban. A third component, which has not received a great deal of attention from policymakers or regulators, involves the effect of the manufacturing ban on information service competition. The potential for such competition between AT&T and the BOCs, and the trend toward integrating intelligence into equipment through software design, has caused AT&T to refuse to disclose proprietary software information to the BOCs. Because BOCs cannot use AT&T equipment to its fullest capacity without this software information, they are driven to purchase equipment from foreign manufacturers. If BOCs were permitted to manufacture equipment for their own use, incorporating software into its design, competition in the information services market would benefit and BOC reliance on foreign vendors would diminish.

Lifting the manufacturing restriction would not only make the domestic market less vulnerable to foreign suppliers, it also would make the regions more effective competitors in service and equipment markets abroad. It is ironic that the MFJ permits the regional companies, under waiver, to manufacture and sell equipment outside the U.S., because their incentive to do so is undercut by their inability to manufacture at home. If there is no opportunity to recover R&D investments at home, it is unrealistic to expect companies to make such investments abroad.

Our Nation's telecommunications policy should have four goals. It should: (a) preserve universal, reliable, state-of-the-art service for all customers; (b) encourage research and technological development; (c) rely increasingly on competition, not regulation; and, (d) foster the penetration of U.S. equipment manufacturers in both domestic and foreign markets. These goals should be advocated in clear policies by the Congress and implemented by the FCC.

Policymaking today, however, is hamstrung by the MFJ's restrictions that have outlived their usefulness. They also continue to limit the regional companies' ability to make business decisions for themselves that serve the interests of their ratepayers. This arrangement serves neither consumers' interests nor the national interest. BellSouth supports the Committee's review of pending legislation and hopes it will lead to a realignment of the telecommunications policymaking process and a more competitive environment at home and abroad. To accomplish this, a "public interest" standard should be substituted for the narrow and literal enforcement of the MFJ's restrictions that were designed for a different world.

II. CONGRESS AND THE FCC SHOULD GET BACK INTO THE TELECOMMUNICATIONS POLICYMAKING BUSINESS

Our Nation's telecommunications policymaking apparatus has become cumbersome and unfocused since divestiture because the MFJ has added an additional (and sometimes inconsistent) layer of regulatory control to the mechanism already in place. As a result of the Court's responsibility for enforcing the MFJ as written five years ago, the role of other government entities in the policymaking process has been diluted and valuable resources and expertise in the Congress, Executive Branch, and FCC are under-utilized. In addition, application of the broader "public interest" standard to the policymaking process, rather than the narrow language that the Court must apply, would more adequately protect the interests of ratepayers and competition. The MFJ, as an antitrust matter has been substantially satisfied. The current debate centers on who will have the authority to modify the MFJ's line of business restrictions—the Court, the Congress, or the FCC, and whether those decisions are to be based solely on antitrust concerns or on the broader "public interest."

A. The "public interest" standard would prevail in U.S. telecommunications policy if the Congress were to transfer MFJ oversight from the Court to the FCC.

BellSouth supports the general thrust of pending legislation that would transfer MFJ oversight from the Court to the FCC because it would remove a redundant, and narrowly-focused layer of regulatory control. As long as the Court retains primary responsibility for overseeing the MFJ, antitrust concerns will be given greater consideration than any other issue.

If authority to implement congressional policy were restored to the FCC, a broader "public interest" standard would lead to a national policy that gives equal consideration to universal service, jobs, trade, labor, competition and national security. FCC proceedings concerning major telecommunications policy matters in the past have been characterized by broad and active participation by a wide variety of interest groups including: labor unions, consumer and public interest advocates, academics and privately-funded think tanks, industry trade associations, and other government entities on the Federal, state and local levels. Such a range of participants routinely broadens the scope of any inquiry by raising special concerns and, hence, FCC decisions consider and tend to reflect such interests. When applied to the "public interest" standard, these procedures are preferable.

Requests for MFJ modifications or waivers, quite properly, are judged against narrower antitrust standards, and proceedings of the Federal District Court generally are not characterized by the same degree of participation found at the FCC. If "diverse and antagonistic sources" truly lead to more robust debate and informed decisionmaking, then FCC procedures and the "public interest" standard are to be preferred over Court procedures and solitary antitrust concerns.

The process would be streamlined further because potential inconsistencies between judicial and regulatory policy would be avoided. The FCC's recent *Computer III* Order provides an excellent case in point. Under the MFJ, BOCs may not provide information services because the Court believed the former Bell operating companies would have the incentive and ability to discriminate against competing information service providers. Under the *Computer III* ruling, however, BOCs may provide enhanced services under certain conditions. BellSouth would like to provide a wide range of information services—such as voice storage and retrieval, message and data processing, commercial, financial, healthcare, and safety information, environmental monitoring and analysis, and educational services—but regulatory inconsistency and uncertainty discourage planning and research necessary to make these services available. Stability and certainty are important to all businesses, but they are especially critical in telecommunications where the pace of technological change is rapid and where competition, both at home and abroad, is rigorous. The MFJ's line of business restrictions also destabilize the entire industry by artifically manipulating markets, limiting services, and discouraging effective competition.

B. Valuable expertise and resources in the Congress, the FCC, and the executive branch would be fully utilized if the Congress were to transfer MFJ oversight from the Court to the FCC.

Prior to divestiture, the U.S. telecommunications policy apparatus was composed of a partnership between Congress, the FCC, and the Commerce Department's National Telecommunications and Information Administration (NTIA). In certain specialized areas, the Departments of Justice, State, and Defense also participated. The relevant congressional committees provided broad policy guidance, NTIA provided expert policy analysis in its role as principal advisor to the President in communications and information matters, and the FCC implemented congressional policy providing specialized resources and expertise.

The major change since divestiture has been the emergence of the Federal District Court and the Department of Justice as the primary arbiters of telecommunications policy, thus excluding the other government participants. This means that a narrower range of issues is likely to be considered in the policymaking process because, as a rule, consumer and industry groups do not participate in Court review of disputed cases. This observation is not meant to be critical of the Court; the antitrust laws are the appropriate standard for such review and views of other parties are not required to be heard. This also means, however, that congressional oversight of telecommunications policies developed by the Court lacks continuity and consistency because it must be conducted on an ad hoc and post hoc basis.

Policymaking by the FCC, on the other hand, is subject to ongoing, and sometimes stringent, congressional oversight and, in some cases like the imposition of subscriber line charges, is directly affected by congressional guidance. In fashioning years of telecommunications policy, the FCC has always sought to foster competition, where appropriate, using the broad "public interest" standard as its guide. The Commission's access charge plan and implementation of subscriber line charges is an excellent example of an attempt to blend the realities of an increasingly competitive marketplace with economic principles. Implementation of subscriber line charges, other related decisions regarding the treatment of WATS access lines, application of access charges to resellers, and freezing the carrier common line charge for terminating switched access usage have reduced the amount of the BOCs' revenues at risk due to the threat of bypass. Revenue losses due to uneconomic bypass of the local switched network have been lessened, permitting carrier common line charges to be reduced in connection with implementation of subscriber line charges. Although this complex series of decisions has had its desired effect, a further shift of a portion of the nontraffic sensitive cost recovery to end users would further minimize bypass and benefit end users without adversely affecting universal service. As the FCC continues to address these issues, congressional oversight will ensure that the interests of all ratepayers are considered.

C. The "public interest" standard is more likely to generate policies that maximize use of the network.

Because the MFJ's line of business restrictions prevent the BOCs from making full use of their network, residence and business customers are denied new information services and products that would allow them to participate fully in the information age economy. By discouraging efficient use of the network, the restrictions could increase costs for all customers.

The MFJ's ban on information services discourages BOCs from conducting the research and development necessary to maintain a state-of-the-art network capable of providing innovative services. The new age of information technology requires sophisticated software—integrated into the network—to perform store, forward and retrieval functions, processing, and monitoring. If the BOCs had such capabilities, they would be better able to maximize use of their network and compete effectively against other domestic information service providers. Local telephone companies also would be able to compete more effectively against foreign entities and guard against future rate increases through network integration, sharing of common costs, and economies of scale.

The benefits of the information age are more likely to be available to consumers as a result of policies developed by the FCC because it would have the mandate to consider all aspects of the "public interest" as part of the policymaking process. Because the Court must give primary consideration to antitrust concerns under the terms of the MFJ, it is less likely to view opportunities for sharing common costs and economies of scale as important benefits that must be encouraged. Maximizing use of the network is critical to the future competitiveness of the BOCs as local service providers, and to residential and business ratepayers who rely on the local network for all their services.

D. The Department of Justice, a party to the AT&T antitrust case, supports transferring administration of the MFJ from the Court.

In its July 9, 1986 comments filed with the Committee on Commerce, Science, and Transportation, the U.S. Department of Justice stated its strong belief that the forum for reviewing the MFJ restrictions should be changed from the Federal District Court to the Federal Communications Commission because it would consolidate Federal telecommunications regulation where it belongs.

The comments note that the FCC is the expert agency created by Congress to regulate the telecommunications industry and has a "much larger, more diverse professional staff" than the Department. Because the FCC staff is composed of lawyers, economists, engineers, and accountants, Justice notes it is "bettter equipped to interpret, implement, and enforce the regulatory regime" established by the MFJ.

In addition, because the FCC has regulatory responsibilities for virtually all aspects of the telecommunications industry, the Department believes it has a much greater capacity for resolving the various issues now arising under the MFJ in a way that would reflect "appropriate sensitivity to the ramifications of that resolution on the industry as a whole."

The Department finds further support for the transfer of jurisdiction because it would "allow important factors to be taken into account" that are not now adequately addressed under the District Court's mandate, such as "national security interests, the interests of telephone users, and the significant role of telecommunications in international trade." The Department notes that review under "a much broader public interest standard" would permit the FCC to consider important factors that neither the Department nor the Court can consider under the antitrust laws, whose sole purpose is to protect competition.

Some interested parties claim that S. 2565 is unconstitutional because it "strips the court" of its authority by transferring a pending case from the U.S. District Court to the FCC and exceeds congressional authority. These charges are wrong for several reasons. Since the government's antitrust suit against AT&T was settled prior to completion of the trial, the parties terminated the litigation by agreeing to modify the 1956 AT&T Consent Decree; thus, the case is no longer pending. Court stripping also is not at issue because the MFJ is a consent judgment and hence resembles a contract whose terms have been agreed to by litigants. The bill does not exceed congressional authority since the Congress currently has the power to alter or repeal the antitrust laws of the U.S. through legislation. If the Congress can change the antitrust laws, it also can change a consent decree that was entered into for the purpose of enforcing the Nation's antitrust policy.

Finally, in its more recent statement before the Senate Commerce Committee, the Department testified that Congress should act quickly to consolidate regulatory responsibility for the telecommunications industry in the FCC because of the inconsistencies between the "theory" and the "practice" of the Decree. The Decree's competition-based policies were supposed to yield significant benefits for ratepayers and competitors alike, but the Department has concluded that it actually limits competition, thus causing unintentional harm to those it was supposed to benefit.

III. THE "FEDERAL TELECOMMUNICATIONS POLICY ACT OF 1986," S. 2565

Appearing before the Senate Commerce Committee on September 10th, Majority Leader Dole testified that the question before the Congress is not whether responsibility for Federal telecommunications policymaking should be transferred from the Federal judiciary, but when and to where? The Senator also reminded the Committee that S. 2565 "is a simple procedural bill" that does not consider the merits, or the future, of the line of business restrictions. S. 2565 would return the job of "active oversight" to the Congress, but rely on the FCC, as the expert agency, to regulate the industry guided by the "public interest" standard.

A. Purpose of S. 2565

In his statement accompanying introduction of S. 2565, as well as in testimony before the Commerce Committee, Senator Dole explained that there is a need to consolidate responsibility for regulating the industry because the current environment is like a "three ring circus" where the regional holding companies must satisfy the Justice Department, the FCC, and a Federal Court. Under this arrangement, it is difficult to "foster a competitive and technologically innovative industry."

Senator Dole also explained that he first became interested in this subject last August while heading a congressional delegation to the Far East to address the growing trade imbalance with Japan. He learned that our world telecommunications equipment trade account had shown a surplus of $203 million in 1981, but was headed towards a deficit of $1.8 billion in 1985. He also discovered that the U.S.-Japan trade picture had deteriorated from a $323 million deficit in 1981 to a $1.2 billion deficit in 1985.

Although the Senator recognizes that the U.S. has become a net importer of telecommunications equipment for a variety of reasons, including "the dollar, the quality of foreign products, and the lack of access to foreign markets," he also concludes that the decline of the U.S. position can be traced to the MFJ's ban on BOC manufacturing, which has taken "some of our most efficient companies entirely out of the world telecommunications equipment market." Finally, Senator Dole testified that:

"[I]t is absurd that telecommunications policy is being made without any regard given to trade concerns. By having policy made in the wrong arena and by the wrong standard [i.e., antitrust not public interest], we are placing blinders on the policymakers. That situation would be corrected by transferring jurisdiction over telecommunications policy to the FCC."

B. Proposals to amend S. 2565

Chairman Danforth's proposals to amend S. 2565 rest on three presumptions: (a) access to, and usage of, the local telephone network must be universally available at fair and reasonable rates; (b) the primary objective of the FCC should be to preserve the universal availability of affordable telephone service; and (c) whenever possible, competition rather than government intervention should be the preferred regulator.

Although he has not released detailed information about proposed amendments, Chairman Danforth has expressed strong interest in considering language that would safeguard ratepayers and competition. For example, he is interested in requiring the FCC to consult with the Attorney General, the Secretary of Commerce, and, in some cases, the U.S. Trade Representative, the Secretary of Defense, and other appropriate Executive Branch agencies before reaching a decision about lifting the MFJ's line of business restrictions. He is not yet certain what weight should be accorded the views of these parties, how much time they should be given to express their views, or whether they would be granted veto authority over an FCC action, but he believes these issues must be given serious consideration.

He also is uncertain about what standard or competitive test the FCC should apply to requests to modify or eliminate the line of business restrictions. For example, he is considering different tests for entry based on whether it is accomplished through acquisition versus independent venture.

Senator Danforth's proposals also focus on accounting, audits and cost allocation, and how best to ensure that local ratepayers do not directly or indirectly subsidize the competitive ventures undertaken by the regional parent. A main issue here is the extent to which Federal and state regulators are able to oversee such activities.

Other concerns include the protection of customer proprietary information, disclosure of network information, transfer of assets between regulated and competitive affiliates, debt (and other) financing of competitive ventures by the parent company, the need for separate subsidiaries, the standard for judicial review, and the need for penalties and forfeitures for violations of FCC regulations.

Although Chairman Danforth has not yet resolved any of these concerns, he is determined to broaden the S. 2565 debate to include consideration of these issues and, ultimately, amend Senator Dole's bill to include a variety of ratepayer and competition protections.

C. Comments on S. 2565

BellSouth has two major concerns about S. 2565. Majority Leader Dole has stated that the purpose of his bill is to effect a simple change of venue—to consolidate regulatory authority over the telecommunications industry in the FCC. S. 2565, however, actually goes far beyond that modest objective and, as introduced, would significantly expand the FCC's regulatory authority over the regional holding companies and their local operating companies. The second concern is that if the Congress is genuinely interested in limiting the Court's policymaking authority and asserting itself in this field, Senator Dole's procedural proposal may not be sufficient.

First, S. 2565, as introduced, would grant the FCC expansive authority not only to modify or eliminate the BOCs' line of business restrictions, it also would allow the FCC to impose the fully panoply of regulation on the competitive activities of the BOCs' parent and affiliated companies. Absent specific language prohibiting such regulation, the FCC could, on its own, impose restrictions similar to those proposed by Senator Danforth. This concerns BellSouth because such an approach would single out the regional companies for extraordinary regulatory control that ultimately will disserve ratepayers, competition, and U.S. technological leadership.

The FCC's approach to regulating the BOCs should focus on two issues: ratepayers welfare and network standards. As long as universal, reliable, state-of-the-art local service is assured, and access to the BOCs' local network for competitive long distance and information service providers is guaranteed, neither Congress nor the FCC should find it necessary to impose a higher degree of regulation on the BOCs or regional companies than is appropriate for other companies that provide a mix of regulated and competitive services, such as AT&T, MCI and U.S. Sprint. This approach, of course, is based on the presumption that a detailed accounting plan is in place that will prevent cross-subsidies between a region's competitive and regulated undertakings.

Second, the Dole approach does not contain a statement of congressional policy concerning the future of the line of business restrictions, which is the focus of this debate. If Senator Dole's original purpose is to be addressed—reversing the U.S. trade deficit by increasing the competitiveness of the regional companies and BOCs—then Congress should eliminate the MFJ's manufacturing and information services restrictions, in particular, and direct the FCC to implement regulations designed to effect such a policy.

If the Dole bill were enacted as introduced, congressional focus would be on preserving the status quo, rather than on expanding or improving services and facilities that could be available to residential and business consumers in the future. This approach trades long-term benefits for short-term security and ignores the history of the domestic telephone industry and its role in the development of a worldwide information age society.

The U.S. telecommunications industry does not operate in isolation from the world market. In order to compete effectively, U.S. companies need a focused, reasoned national policy that encourages research, development, innovation, and competition. If Congress genuinely seeks to strengthen the domestic industry and reverse the trade imbalance in telecommunications equipment, it should express a clear policy preference and not risk substituting the existing regulatory regime, i.e., the MFJ's line of business restrictions, with protectionist policies that stifle innovation and competition.

As the worldwide telecommunications market becomes more competitive, BOCs must be free to respond in the interests of all their customers. As long as the BOCs core business is subject to appropriate regulatory controls and local customers' interests are protected, the Bell operating companies should be free to provide the same types of equipment, services, and facilities, subject to the same regulatory treatment, as vertically-integrated companies such as AT&T, MCI, U.S. Sprint, or any foreign supplier that enters the U.S. market. Amendments that limit the BOCs' ability to compete fully, also will limit their ability to respond competitively to market forces, will disserve all BOC customers, and will damage the long-range competitiveness of the regional companies at home and abroad.

In previous testimony before the Senate Subcommittee on Communications, BellSouth stated that the FCC's restriction against joint marketing of basic services, enhanced services, and customer premises equipment places BellSouth under a severe handicap at a time when users, including the Federal government, demand "one-stop shopping." BellSouth also said that relief from these restrictions would allow BellSouth to compete effectively with full service providers and would enhance its ability to provide good telephone service in the traditional market, the local exchange.

This testimony recently was underscored by AT&T's new chairman, James E. Olson, who said that under his leadership AT&T would seek to position itself as the "total solution" for business customers by using an integrated sales force to sell long distance, data services, and customer premises equipment in a single package. AT&T's director of marketing strategy planning believes this approach, which "is what the market demands," will position AT&T to help manage customers' communications needs worldwide. Olson also has made it clear that for AT&T to compete effectively, it must be able to provide all services and equipment to all customers, including the full range of computer hardware and software, the design, construction and maintenance of local area networks, as well as the ability to bypass the local network by providing transport to the point-of-presence. He does not view such a plan as inconsistent with AT&T's vertically-integrated structure, in fact, he considers it a necessary advantage in today's telecommunications marketplace.

BellSouth has the expertise and resources to meet customer demands for "one-stop shopping" but is prohibited from taking the joint marketing approach described by AT&T above because of the FCC's structural separation requirements. This result is inconsistent with the original purpose of divestiture and constitutes poor public policy because it eliminates potential competition and restricts consumer choice.

If responsibility for the MFJ's line of business restrictions were transferred to the FCC and, more importantly, the "public interest" standard were applied to questions about the future of the restrictions, it is more likely that consumers would benefit from greater choice, the U.S. labor force would benefit from a more robust industry, and competitiveness would improve because of the resources and expertise the regions would bring to these markets.

IV. OTHER PENDING LEGISLATION

The striking difference between the Dole bill and bills introduced by Senator Gore and Congressmen Swift and Tauke is that the Gore and Swift/Tauke bills contain clear statements of congressional policy with respect to the future of the MFJ's line of business restrictions. In addition, Gore-Swift/Tauke would restore the pre-divestiture policymaking process in which the FCC implements policies developed by the Congress using the "public interest" standard as its guide.

A. The "Telecommunications Equity Act of 1986," S. 2362

In comments accompanying introduction of S. 2362, Senator Gore stated that the AT&T divestiture has caused widespread customer confusion and has placed rural customers in jeopardy. He noted also that although the Justice Department and FCC are in a position to responsibly manage the transition from a monopoly system to one with many competitive players and where all customers are supposed to benefit, this has not occurred.

S. 2362 has several purposes. The bill's premise is that a number of FCC policies, as well as the MFJ's line of business restrictions, combine to hurt rural customers disproportionately. For this reason the bill not only proposes to permit BOCs to provide information services (not including electronic publishing) and engage in manufacturing, subject to FCC regulation, it also would require the FCC to report to Congress on the economic benefits of permitting BOCs to provide interexchange service in areas where equal access is available.

In addition, however, it also would (a) suspend the FCC's 1984 access charge decision; (b) preserve toll rate averaging and carrier common line pooling; and, (c) retain a universal service fund for high cost companies. These measures are all designed to help rural ratepayers. While the Senator believes that bypass constitutes the "number one" threat to universal service, he does not agree that Federally-mandated access charges have reduced bypass at all.

Senator Gore believes that local rates have been kept artificially high because the MFJ's line of business restrictions keep significant revenues from flowing into the local rate base. He also believes they are counter-productive because they prohibit the regional companies from engaging in efforts to reduce the growing trade deficit in telecommunications equipment.

B. The "Telecommunications Equipment and Information Services Act of 1985," H.R. 3800

In their "Dear Colleague" letter sent shortly after H.R. 3800 was introduced, Congressmen Swift and Tauke stated that customers would receive better telephone service and the U.S. would remain a world leader in telecommunications if the MFJ were modified.

The congressmen, joined by 171 co-sponsors, believe that the benefits of the information society will be available to all customers, not just large businesses, if BOCs are permitted to participate in competitive activities where they can make a profit. The note that under the MFJ's current restrictions, other telecommunications companies "are free to come in and carve out large chunks of [the BOC's] basic business" and by bypassing the local switched network, "take away [the BOCs'] largest and most lucrative customers."

H.R. 3800, as introduced, would permit BOCs to provide information services (not including electronic publishing) and engage in manufacturing, subject to FCC regulation. Because they are concerned about the mounting trade deficit in telecommunications equipment and the stability of the U.S. labor force, the sponsors would permit the BOCs to engage in these activities within the United States only. In addition, they would require the FCC to report to Congress annually on the impact of lifting the restrictions on employment in the telecommunications equipment manufacturing and information service industries.

Within the last month, Congressmen Swift and Tauke announced their intention to amend their original bill with the following proposals: (a) require comparably efficient interconnection before BOCs can offer information services; (b) give other manufacturers the same opportunity to sell network-related equipment to the BOCs that BOCs provide themselves; (c) require the FCC to assign costs to the line of business that causes them; (d) prohibit the transfer of assets back into the rate base unless there is evidence that telephone customers will benefit; (e) require the FCC to adopt rules governing transactions between related companies; (f) require BOCs to provide the FCC with results of an annual audit verifying compliance with these requirements; and (g) create a new Federal/state joint board to advise the FCC on ratepayer and competition protection.

C. Comments on other pending legislation

BellSouth strongly supports elimination of the MFJ's line of business restrictions and application of the "public interest" standard to questions about their future. It has become abundantly clear over the last five years that these restrictions are inconsistent with the MFJ's original purpose, which was to increase competition. The ban on manufacturing has contributed to this country's massive trade deficit in telecommunications equipment, acts as a disincentive to invest in research and development, and inhibits the development of new information services.

The same is true with respect to the ban on long distance service (i.e., interexchange). Although toll or long distance competition has increased significantly in the last five years, especially as a result of equal access implementation, many ratepayers still are served by only one long distance provider—AT&T. Although the MFJ prohibits the BOCs from providing long distance service between LATAs, it does not prohibit them from providing long distance service within their LATAs. In fact, the BOCs' share of toll revenues in 1985 was approximately 20 percent of total toll revenues nationwide. If the BOCs also were permitted to provide, or resell, long distance service between LATAs, some ratepayers who do not now have a choice between carriers might benefit from being able to choose between AT&T and another long distance provider.

Finally, although eliminating the information service and manufacturing restrictions would allow consumers to choose between a greater array of services and products offered by a larger number of providers, the Gore-Swift/Tauke bills would single out the Bell operating companies for a degree of FCC oversight that is not exercised with respect to any other telephone company that also is affiliated with a telecommunications equipment manufacturing entity. Neither AT&T nor GTE, for example, is subject to the type of control contemplated by S. 2362, H.R. 3800, or their proposed amendments.

It is important to note that a company such as GTE is free to provide all telecommunications and information services in its territory, as well as manufacture equipment. In Tampa and Los Angeles, for example, where GTE is the sole local service provider, it holds itself out as a full service provider to all its customers and competes fully in all markets. The BOCs, on the other hand, may only provide exchange and exchange access services in their territories. Opponents of S. 2565, and the other bills discussed above, make theoretical distinctions that do not exist in practice between the BOCs and companies such as GTE. If the BOCs are presumed to have the opportunity and incentive to discriminate against competitors in their service areas, then the same presumptions should be applied to a company such as GTE which operates as a vertically-integrated provider in its service areas.

V. CONCLUSION

The primary purpose of divestiture was to encourage competition in the telecommunications industry. But in the last three years at least, policymakers have asked themselves—How is competition served if seven companies, whose asset base represents about half of the U.S. telecommunications industry, are prohibited from participating in key markets? They clearly recognize the anomaly that exists between the theory of divestiture and its terms in practice and conclude that the line of business restrictions disserve the public by limiting consumer choice, discouraging competition, and encouraging foreign domination of U.S. equipment markets.

The telecommunications environment has changed significantly since 1982 when the government announced settlement of its antitrust suit against AT&T. The most significant, new element in the domestic environment is the extent to which the equipment market is dominated by foreign companies. Another change involves the players and their structure. The vertically-integrated AT&T still dominates the long distance and manufacturing markets and, as dicussed above, plans to expand vigorously into other, related markets. Familiar players, such as AT&T, MCI, U.S. Sprint, and other long distance carriers, also create new, competitive pressures for the BOCs because—unlike the regional companies—they are permitted to provide the full range of services to their customers.

As discussed above, competition between long distance carriers also has increased primarily because of equal access implementation. And the number of information service providers (and services) also is expected to increase when the FCC's recent *Computer III* Order requiring comparably efficient interconnection and open network architecture for competitive providers of enhanced services is implemented. In addition, major cost allocation concerns soon will be resolved when the FCC implements a new accounting system that will eliminate the possibility of cross-subsidization between regulated and non-regulated ventures. BellSouth recognizes the crucial public policy importance of this cost separation scheme fully supports the FCC's efforts to implement a well-reasoned plan that assures an open and fair competitive environment for all service providers.

This is a very different environment than in 1982 when settlement was announced, or in 1984 when divestiture occurred. Add to this, concerns about the mounting trade deficit, the future of the U.S. labor force, and participation of U.S. citizens in the evolution of a worldwide information economy, and Congress must conclude that our Nation's current policy falls short of encouraging full and fair competition.

Contrary to the testimony of the regions' competitors, "seven new AT&Ts" would not be created if the Congress were to eliminate the MFJ's line of business restrictions because new regulatory controls involving accounting, and access to the network have produced a climate that is very different from the one that led to the AT&T break-up. These regulatory controls, which were not present in the pre-divestiture environment, will increase competition and yield significant benefits for ratepayers because they will encourage new technological development which, in turn, will encourage more efficient use of the network. Combined with MFJ relief, these safeguards also will enhance the industry's competitiveness at home and abroad.

Congress must understand that opponents of MFJ relief have one objective—to restrict competition by keeping the regional companies and the BOCs out of all markets except for exchange and exchange access. These opponents do not oppose BOC entry because of harm that might come to ratepayers and competition, they oppose BOC entry because of harm that may come to themselves as a result of smaller market share. Their motivation is "self interest," rather than the "public interest," and they would eagerly trade this Nation's position in the global information economy for a larger share, for themselves, of a particular segment of the domestic telecommunications business.

Congress must return to the business of shaping a national telecommunication policy, and direct the FCC to implement that policy, so the benefits of divestiture can be enjoyed by all ratepayers. Our domestic policy should subject foreign entities doing business in the U.S. to the full strength of the U.S. industry in all markets—including competing head-to-head with the regional companies as full service providers. The full U.S. industry—including the regional companies—must turn its attention toward policies that will lead to a stable and competitive industry, and away from policies that restrict competition selectively. The regional companies are eager to participate fully in this new environment but, to do so effectively, they must be allowed to choose the strategies that best serve their ratepayers. Pending legislation that consolidates regulatory authority over the telecommunications industry in the FCC and restores the "public interest" to the policymaking process is an important step in that direction. A congressional policy tht eliminates the line of business restrictions, however, is more likely to lead to a national policy that will encourage competition at home and abroad, restore U.S. technological leadership, and serve the interests of all ratepayers.

STATEMENT OF THE COMPUTER AND BUSINESS EQUIPMENT MANUFACTURERS ASSOCIATION

The Computer and Business Equipment Manufacturers Association (CBEMA) is pleased to submit this statement for the hearing record on S. 2565, The Federal Telecommunications Policy Act of 1986. The Chairman raised a number of very legitimate concerns in the attachment to the Committee's August 28 press release. While we have not responded to each question individually, we have enumerated basic concerns which we believe Congress must address in this or similar legislation.

CBEMA is the trade association of producers of information processing, business and communications products, supplies and services. Its 38 member companies had combined sales of more than $145 billion in 1985, representing 3.7 percent of out nation's gross national product; fully a third of these revenues are attributable to telecommunications equipment and/or services. Our companies employ more than 1.2 million people in the United States. As such, CBEMA is vitally concerned that the issues under consideration, both implicitly and explicitly, in S. 2565 not undermine the currently robust state of competition in our industry.

CBEMA commends the Chairman for the serious concern he expressed on the matter of safeguarding ratepayers and competition in the August 28 press release and in the various amendment proposals he attached to the release. We concur with the Chairman's view that these issues are paramount, and we encourage the Committee to move slowly and to consider carefully the impact that actions taken by Congress or the Federal Communications Commission (FCC) may have on them.

CBEMA is not opposed to changing the forum for adminstering the Modified Final Judgment. CBEMA also is not opposed to BOC participation in new lines of business such as the manufacture of telecommunications equipment or the provision of information services, so long as such activity does not represent an impediment to competition in those lines of business. However, CBEMA does not believe it is timely for Congress to make either determination.

Moreover, should Congress decide to enact legislation to transfer administration of the decrees to the FCC, it is essential that Congress also set forth basic principles or guidelines to which the FCC must adhere in determining what new fields of activity the Bell Operating Companies (BOCs) may enter and under what conditions. The potential for significant competitive and anti-trust problems exist when the BOCs, controlling the local telephone monopolies, participate in new lines of business in direct competition with companies whose offerings depend on access to that same local monopoly. Such principles should include:

> An affirmation by Congress that information services and other historically unregulated services will not be subject to regulation under Title II of the Communications Act of 1934;
>
> A requirement for open access to local exchange networks, through implementation of concepts such as Open Network Architecture;
>
> A requirement that the costs and risks of investment in any new unregulated activity, established through relaxation of any Modified Final Judgment (MFJ) restriction, must accrue to the BOC stockholders and not the basic service ratepayers;
>
> A requirement that effective safeguards to protect ratepayers and prevent anti-competitive activity be established through FCC proceedings and be in place before any line-of-business restrictions are lifted from the BOCs; and
>
> In addition to considering removal of line-of-business restrictions from the BOCs, Congress and the FCC should fully explore and implement means of permitting competition in protected monoply markets which are currently reserved for the BOCs.

In addition to setting forth guidelines for the FCC, Congress should also address the implicit State and Federal jurisdiction issues involved.

Although S. 2565 has been characterized by its sponsors as a simple transfer of authority, we caution the Committee that there is nothing simple about the underlying issues. Congress should realize that with this transfer of authority, it will set the direction of telecommunications policy in the U.S. and the results will be far-reaching. CBEMA believes Congress should await the results of the Justice Department's study of the state of competition in the industry before changing the forum for administration of the consent decrees.

We thank you for this opportunity to comment on S. 2565, The Federal Telecommunications Policy Act of 1986. We hope our view are of assistance. If we may provide the Committee with further information, please do not hesitate to call on us.

STATEMENT OF FREDERICK D. DORSEY, PEOPLE'S COUNSEL OF THE DISTRICT OF COLUMBIA

INTRODUCTION

Pursuant to D.C. Code Section 43-406(d)(1981 ed.), the People's Counsel of the District of Columbia (OPC-D.C.) is the statutory representative of the consumers of utility service, including consumers of telephone service provided by the Chesapeake and Potomac Telephone Company (C&P-D.C.).

As the statutory representatives of District of Columbia utility ratepayers, the Office of the People's Counsel's abiding concern is that the interest of its constituency—District of Columbia ratepayers—are well-protected. Telephone service is essential. According to law and tradition, the primary function of regulators is to ensure the continued provision of this essential service at "just and reasonable rates." This testimony focuses on ratepayer safeguards that the Office believes are necessary in order to protect ratepayers from cross-subsidizing competitive, unregulated ventures of the BOCs and to shield ratepayers from any risk associated with new unregulated business ventures of local exchange telephone companies. These safeguards are based, in the words of the Communications Act of 1934, on the right of "all of the people of the United States to. . . communications with adequate facilities at reasonable charges. . ."

In this regard, the Office is concerned that neither of the existing forums, the U.S. District Court or the FCC, has been sensitive or responsive to the interests of consumers. Thus, a simple transfer of jurisdiction in and of itself, fails to guarantee ratepayer protection. Accordingly, the focus of this testimony is on what is perceived to be the real issue at hand: What provisions or guidelines are necessary to preserve universal service at affordable rates irrespective of the chosen forum? It is critical that any legislation adopted by Congress require input from, recognition of, and be responsive to consumers.

CONGRESS SHOULD ESTABLISH SPECIFIC GUIDELINES FOR THE FEDERAL-STATE JOINT BOARD IN ORDER TO SAFEGUARD RATEPAYERS FROM CROSS-SUBSIDIZATION

Scope of S. 2565

Although Section 6 of S. 2565 grants the FCC the power to regulate the BOCs' entry into unregulated businesses, as presently drafted it fails to recognize the legitimate interest of state regulators in determining whether and to what extent line of business restrictions should be removed regarding intrastate services. State regulatory commissions are best equipped to determine how removal of a given restriction will affect competition within their jurisdictions and what the benefits and costs to ratepayers will be based on particular local conditions. Hence, state regulators, such as the District of Columbia Public Service Commission, must decide whether a specific telecommunication service proposed by a Bell Operating Company is in the best interest of local ratepayers.

In short, state regulatory agencies should retain their exclusive recognized jurisdiction over intrastate telecommunication services offered by local exchange companies. Thus, the scope of S. 2565 should be redefined in order to address only the interstate aspects of diversification that are beyond the states' ability to regulate.

In this regard, the Office notes that the implementation and definition of the methods, procedures, and practices to be utilized to provide ratepayer protections should be the responsibility of a Joint Federal-State Board. Any legislation that is ultimately approved by Congress should include a provision establishing a Federal-State Joint Board. Input from the existing dual regulatory system in formulating accounting safeguards would ensure inclusion of both a national and local perspective on how best to protect the interests of local ratepayers.

Accounting and cost allocation safeguards

In order to assist the Joint Board in promulgating accounting and cost regulations for competitive ventures that will protect against cross subsidization, Congress should provide definitive standards to the Joint Board. Currently pending before the House are at least two other bills directed toward diversification issues similar to those present in the Dole Bill. These bills include H.R. 3687, introduced by Representatives Tauke and Swift, and H.R. 3800, introduced by Representative Wyden, which would permit the Bell Operating Companies to provide information services and to manufacture telecommunications equipment. Recently introduced ratepayer protection amendments proposed for both bills may serve as working examples of provisions that should be incorporated into the Dole Bill.

Should Congress determine that line of business restriction waivers are to be entertained by the FCC, a provision should be added to the Dole Bill that makes implementation of appropriate cost-allocation rules a prerequisite to the granting of a waiver. H.R. 3800 contains such a provision. Given the natural incentives of the Bell Operating Companies to cross-subsidize, it is unwise to allow telephone companies to offer unregulated services and products free from any cost allocation requirements, even for a short period of time.

In order to effect a fair and reasonable allocation of costs between regulated and unregulated services, the Office recommends that cost allocation procedures be structured to identify the costs of the regulated enterprises, not those of unregulated services. This avoids relying primarily upon residual cost pricing for local exchange service. Residual cost pricing generally results in greater assignment of costs to local exchange service—those costs not identified as specifically related to some other service will necessarily be responsibility of local exchange service. To avoid such improper and excessive allocation of costs to local exchange ratepayers, the Office recommends that residual pricing be minimized, if not altogether avoided.

The Office further recommends that management's reasons for making investments be incorporated into any allocation methodology that may rely upon usage as an allocation factor. If for example, a local exchange company undertakes additional investment in order to provide information services and/or to do same more economically, a portion of those investment costs should be directly attributed to information services. Although it is likely that the facilities, once in place, will also be used for the provision of other services, i.e., local and long distance service, such use should not cause all investment costs incurred to be shared. Instead, the new service which has driven or caused the costs to be incurred should bear their expense. Costs not directly attributable to information services can be properly allocated across all services (including information service) based on a measure such as relative use.

The ratepayer protection amendments in H.R. 3800 and H.R. 3687, as amended, which attempt to define cost allocation standards that the FCC should follow, seem to minimize reliance on residual pricing of regulated services and recognize management's reasons for making investments, although both emphasize defining the costs of the unregulated services. The standards of cost allocation found in H.R. 3800 and H.R. 3687, as amended, reflect a legitimate means of incorporating cost causation and investment decision reasoning into the allocation process. The Office recommends a similar provision be written into the Dole Bill.

If it is determined that structural separation is not required, Congress should include cost allocation standards that would preclude cross subsidization. Such standards should focus on determining the cost of the regulated operations of each company and should avoid or minimize residual cost pricing. Additionally, if the cost methodology utilized in the allocation process is to rely on usage, the company's reasons for making investments should be incorporated into the cost methodology. Finally, diversification into unregulated activities, if it does occur, should only be permitted after cost allocation safeguards are in place, and when the company has made an affirmative showing that it has compiled with such safeguards.

Annual audits

A related issue of importance to consumers is whether the telephone companies should be regularly audited to ensure that prescribed regulatory safeguards are implemented. Rigorous auditing procedures must be established to minimize opportunities of the telephone companies to subsidize unregulated activities by inappropriately shifting costs to regulated activities.

Both H.R. 3800 and H.R. 3687 address the issue of annual audits of the financial records of the BOCs. Annual audits were proposed in the cost allocation proceeding, (CC Docket No. 86-111) initiated by the FCC. It is the view of the Office that the adoption of standards for the auditing process must be driven, first, by the overall objective of a regulatory environment that is responsive to the interests of ratepayers and, second, by the underlying purpose of such audits, which is to test the results and reasonableness of the allocations and assignments.

It is critical that measures be taken to ensure the absence of company bias by the selected auditors. The selection of auditors unaffiliated with the companies involved serves to ensure the integrity and reliability of review process. It is also critical that all pertinent documents required for a thorough review of the company be made available to the auditors. The auditors should be vested with the authority to review all documents and data reasonably relevant to the companies' accounting practices. A presumption of "relevance" and "availability" regarding these documents should be imposed. The burden of proof should be on these companies that object to the release of documents. Finally, all costs incurred by the FCC in conducting audits should be recovered as fees from the companies' competitive affiliates.

Failure to impose adequate regulatory oversight controls will undoubtedly thwart any effort to advance the development of a national telecommunications policy in a competitive environment that is responsive to the public interest.

Financing new ventures

It is a matter of basic fairness that ratepayers who do not share in the profits of BOC diversification should not bear the risks associated with such diversification activities. In an effort to prevent such action, Judge Harold H. Greene set forth four conditions the Regional Holding Companies (RHCs) must agree to before a waiver of the line of business restrictions can be obtained.

One condition prohibits the RHCs from financing debt to allow the proposed new subsidiaries to engage in competitive activities. Rather, the new competitive subsidiaries must obtain debt financing on their own credit. If an RHC were able to raise funds jointly for both its competitive ventures and its regulated services, the cost of capital for regulated telephone service would likely increase, due to the increased risk associated with the competitive venture. Ratepayers would then effectively subsidize the activities of the competitive venture by assuming, through higher interest rates, part of its costs. As recognized by Judge Greene, these same ratepayers are not likely to receive the concomitant benefits associated with diversification. Hence, this financing condition protects the telephone ratepayer from assuming any financial risks associated with the BOCs' competitive ventures.

Although the Dole Bill adopts the restrictions of the Modified Final Judgment and Judge Greene's conditions regarding those restrictions, the proposed bill authorizes the FCC to modify, waive, or rescind the rules whenever it determines such action to be in the "public interest." Consequently, S. 2565, as drafted, would allow the FCC to eliminate Judge Greene's financing restriction.

Representative Swift's ratepayer protection amendments to H.R. 3800, however, preserve Judge Greene's financing restrictions. H.R. 3800, as amended, specifically delineates a number of financing safeguards that insulate ratepayers in the event of a failed business venture by the BOCs by providing a comprehensive ratepayer protection scheme. Similar financing restrictions should be written into the Dole Bill.

Transfer of assets

The transfer of assets between the telephone companies and their competitive affiliates is an issue that directly affects the interests of the ratepayers of the regulated utility. A utility's assets are acquired through the rate funding process; ratepayers pay for the development of services, products, and the training of personnel, and they indirectly contribute to the company's general standing and reputation. Measures should be implemented to ensure that ratepayers are not deprived of any derivative benefits because the utility transfers assets to its unregulated subsidiaries at under-valued levels. Various bills have been introduced, such as Congressman Wyden's H.R. 3687, to provide a method for ensuring that ratepayers are adequately compensated for asset transfers between the telephone companies and their subsidiaries. The Office supports the concept of promulgating rules governing the transfer of assets. Indeed, the absence of such rules and regulations will serve to undermine other ratepayer protections and will further exacerbate the likelihood of cross-subsidies.

The affiliation of an unregulated operation with a regulated entity bestows certain tangible and intangible benefits upon the unregulated subsidiary. For example, a utility entering new ventures may have an incentive to transfer assets (i.e., equipment and plant) acquired with ratepayer funds to its unregulated subsidiaries at below value costs. Such a transfer would result in a windfall to the competitive affiliates and leave ratepayers inadequately compensated. The primary objective in establishing the guidelines governing these transactions must be to protect the interests of the telephone companies' ratepayers.

In concert with stringent guidelines governing the transfer of tangible assets, rules that serve to compensate ratepayers for their contribution to the intangible benefits conferred upon the unregulated subsidiaries are also necessary. It cannot be disputed that benefits accrue to the subsidiaries from use of the regulated entities' reputation and credit standing in the business community as well as the companies' revenue and earning stability. An unregulated affiliate may also have direct access to the in-house expertise of the regulated company. These benefits, although intangible and difficult to quantify, give the unregulated subsidiary certain advantages over its competitors. Yet most, if not all, of these "intangible assets" were developed with ratepayer support.

The concept of ascribing a monetary value to intangible assets, such as reputation, is not new. In the business community, royalties are commonly paid for the use of an established company's name. Increasingly, as utility diversification spreads, regulators are grappling with analogous ways to compensate ratepayers for intangible benefits. State commissions in California and New York have already proposed solutions to this problem.

Ratepayers should benefit from the contributions they have made to the development and growth of the utility companies. The telephone companies must not be permitted to siphon off ratepayer contributions by having unfettered authority to transfer assets, whether tangible or intangible, without compensating their ratepayers.

CONCLUSION

Ratepayers are particularly vulnerable at this stage of divestiture and deregulation. As telephone companies diversify into competitive ventures and federal rules are proposed to ease structural separations, guidelines to safeguard the interests of ratepayers ought to be paramount. These safeguards must include, at a minimum, accounting and cost allocation rules and regulations to protect consumers from cross subsidizing new competitive BOC ventures. They must include rigorous auditing procedures for evaluating the accounting practices of the telephone companies to ensure that they comply with the prescribed allocation and accounting rules. Further, such rules must be reasonable and in the interest of ratepayers.

In addition, a mechanism must be established to ensure that ratepayers, who bore the initial cost of investment in assets, are adequately compensated when these assets are transferred from the regulated entity to its competitive affiliates. Financing safeguards similar to Judge Greene's restriction on subsidiary debt financing are also necessary in order to insulate ratepayers from bearing the risk of new business ventures when they will not share in the profits.

Finally, the Office strongly recommends that a Federal-State Joint Board be established and charged with the responsibility of implementing the ratepayer protections.

The Office of the People's Counsel of the District of Columbia appreciates the opportunity to present testimony on S. 2565 on behalf of District of Columbia telephone consumers, and welcomes this opportunity to apprise Congress of the legitimate ratepayer concerns with respect to proposed legislation.

Statement of William T. Esrey, President and Chief Executive Officer, United Telecommunications, Inc.

We appreciate the opportunity to express United's views on the complex issues raised by S. 2565. These issues, and the underlying proposal to transfer the forum from the Department of Justice (DOJ) and the Judiciary to the FCC, raise threshold legal questions and underlying practical concerns which must be resolved in the public interest before risking further disruptions in our telecommunications industry.

On the heels of the 1984 break up of the Bell System, the need for stability in our industry is acute. United is especially sensitive to this need. In reliance upon the industry structure established by Government policy leaders through the Bell System Decree, related implementing FCC decisions, and Congressional acquiescence, United, by its subsidiary, U.S. Telecom (now U.S. Sprint - 50% owned by United and 50% by GTE) commenced construction in 1984 of over $2 Billion, state-of-the-art, 23,000 mile nationwide fiber optic, digital switched network. We expect to have approximately 15,000 miles completed by year end. The network will by fully completed by 1989. Until the network is completed, we remain critically dependent upon the facilities of our principal competitor, AT&T to provide service to our customers. Premature deregulation could jeopardize our efforts to bring the most advanced, state-of-the-art, integrated voice, video and data transmission network to this country. It could seriously undermine the grand objective of the AT&T Consent Decree—assuring enduring competition and state-of-the-art technology in long distance services for the public.

Both Congress and the FCC have critical roles to play in assuring that deregulation does not proceed prematurely and that fledgling competition and ratepayer interests are not sacrificed under the banner of deregulation or the banner of international trade. Antitrust decrees designed to protect against past anticompetitive abuses and to promote an environment for enduring competition, innovation and customer choice must not be subordinated.

Before government policy leaders rush to upset our recently vintaged 1984 industry applecart, it would be well for us all to revisit the rationale underlying the Bell System Decree.

We do not suggest that such restrictions should be maintained in perpetuity. Indeed, the Decree itself contemplates that every three years the DOJ will report to the Court on the continuing need for the restrictions. The "Huber Study" is expected for this purpose early in 1987. The NTIA has undertaken a similar study to be released early in 1987 too. The linchpin for removal of the restrictions is whether the BOCs have lost "the ability to leverage their monopoly power into the competitive markets from which they must now be barred". (552 F. Supp. 131, 194; see also, MFJ section VIII(c), 552 F. Supp. 131, 231).

We submit that this test will not be met until the local exchange bottleneck problem is resolved by the achievement of far more nearly ubiquitous "equal access" than exists today and until there is substantial facilities based competition in the provision of local telecommunications services. The impending Huber and NTIA studies should focus on this concern and hopefully provide objective, unbiased assessments.[1]

At minimum, before administration of the Decrees is shifted, the FCC should be required to initiate a docket designed to determine facts and FCC policies forming a transition plan for assuring enduring competition in the principal emerging markets.

Legislation with specific parameters and/or restrictions should not be enacted until Congress and the industry first have the benefit of full disclosure of FCC findings and policies, and the opportunity to respond. This approach should provide due process and help resolve the Congressional quandary over not wanting, on the one hand, to provide the FCC with a blank check for restructuring the industry and not wanting, on the other hand, to engage in "micromanagement".

One approach which might be workable and serve the consumer/public interests would be a requirement that the DOJ provide the FCC with competitive impact findings on all BOC waiver requests. Such findings should be deemed conclusive/determinative with respect to the FCC's Clayton 7 competitive impact responsibility. This factor should be weighted no less than fifty percent in the total weighting of all factors essential to the FCC's decision.

A better, more workable and easier implemented approach would be to simply leave administration of the antitrust decrees in the Judiciary but mandate submission of FCC findings and recommendations to the Judiciary concurrently with those of the DOJ on all waiver requests. The Senate could adopt an enabling resolution urging Judiciary consideration of broader public interest factors,[2] as presented by the FCC in its findings and recommendations, as well as consideration of the competitive impact findings and recommendations of the DOJ. This would assure that our antitrust laws would not be circumvented while giving due weight judicially to broader public interest considerations as presented by expert agencies such as the FCC and NTIA. This also would obviate a critical Constitutional issue.

S. 2565 may be an unconstitutional infringement of the judicial power under U.S. Constitution, Art. III §2 cl. 1. Counsel advise that Congress can modify a consent decree by amending the substantive law underlying the decree,[3] but not by prescribing a change of jurisdiction from one branch of our government to another, thereby depriving the courts of their adjudicatory function. The principle of separation of powers is so fundamental to the very structure of our government that proposals by one branch to usurp or transfer the powers of another appear inconsistent. This legal issue should be resolved, along with many other issues being addressed in your inquiry and by the DOJ in the "Huber Study" and by the NTIA in its study to be released in January, before Congress takes definitive action. We must avoid further instability and uncertainty in an industry beset in recent years with the greatest upheaval in its history. Congress must not act precipitously.

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[1] If and when, through "technical"/"technology" developments, the BOC's "lose the ability to leverage their monopoly power into the competitive markets from which they must now be barred" and thereby justify easing or lifting restrictions, transition will be essential to avoid major industry disruptions.

[2] Under the Tunney Act (Antitrust Procedures and Penalties Act, 15 U.S.C. §16), *courts are required to undertake public interest inquiries* before entering a consent decree. Indeed, this process was followed diligently before entry of the Decrees and, as a consequence, modifications, in the public interest, were made. The Bell System Decree was also affirmed by the U.S. Supreme Court after entry by the U.S. District Court. It follows that this public interest mandate continue throughout judicial administration of the Decree. (See, Bell System Consent Decree, 552 F. Supp. 131, 147 - 53).

Another threshold legal issue presented by S. 2565, counsel advise, is whether the bill would change both the substantive legal standards applicable to the structure and conduct of the BOCs and affiliates, as well as the manner in which these standards are applied. Would the legislation, if enacted, circumvent the antitrust laws with respect to conduct of the BOCs? Obviously, the transfer of the Decrees from an antitrust court to the FCC—which will follow a more liberal public interest standard and possibly issue more permissive decisions as is evident from public statements of FCC officials—would be much less of a deterrent to anticompetitive conduct.[4]

Adoption of the bill, without suitable safeguards, therefore would be tantamount to a dilution of the antitrust laws applicable to our embryonically competitive industry. If, in fact, S. 2565 would circumvent the antitrust laws, the impact of the proposed legislation would jeopardize competition by immunizing dominant companies, previously confronted with serious allegations of anticompetitive acts, from antitrust sanctions for predatory pricing, cross-subsidization, discrimination, etc.

Under the MFJ, the line of business restrictions on the separated BOCs may be removed if the BOC shows ". . .there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter."

Under S. 2565, removal of the several restrictions inthe MFJ would be dependent upon a "public interest" finding by the FCC after notice and hearing. Unclear, however, is whether the present burden of proof would remain, as it should, with the petitioning BOC or whether the FCC could adopt a more liberal procedure. (See, MFJ, section VIII(c), 552 F. Supp. 131, 231).

The following criteria should be included among those used in determining whether specific MFJ restrictions are necessary:

(1) The principal substantive purpose of the divestiture—to promote competition and to create conditions which will reduce the cost and improve the quality and reliability of telecommunications services; and,

(2) The purpose of the consent decree restrictions—to prevent the occurrence or reoccurrence of anticompetitive conduct.

As previously discussed, it continues to be our position that Congress is the appropriate body to determine national telecommunications policy, with a significant FCC role as stated. We reiterate our position that unless and until Congress has the benefit of an FCC transition plan and can, itself, make the fundamental public policy decisions and unless and until the Constitutional issue is affirmatively resolved, administration of the Decrees should stay with the Judiciary influenced by both FCC and DOJ participation as well as by other agencies as appropriate. However, assuming that the threshold legal issues essential to transferring administration of the Decrees to the FCC are affirmatively answered and assuming Congressional resolve to transfer, then we believe that, at minimum, Congress must formulate specific guidelines and safeguards for the FCC. But in order to formulate such safeguards, Congress needs to know specifically what are the FCC's policies and plan(s) for assuring enduring competition in the principal emerging markets. This is especially important in light of public statements by FCC officials favoring even more permissive treatment of BOC waiver requests, the vast majority of which, incidentally, have been granted. All such requests should be considered on a case-by-case basis.

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[3] Even Judge Greene in his August 11, 1982 Opinion in the AT&T case stated that Congress may, of course, enact legislation overturning a consent decree (Fn. 76). However, once the decree is entered, it is the Court, not the DOJ or the FCC, that ultimately must resolve questions of interpretation.

The Constitutional issue, incidentally, is not avoided by maintaining jurisdiction in Judge Greene's court in contemplation of a motion by the DOJ for judicial defeasance of the Decrees, following transfer to the FCC, because Judge Greene may deny such a motion.

[4] While the FCC, under Clayton 7, is "required to consider anticompetitive consequences as one part of [its] public interest calculus," this requirement does not extend to §§1 and 2 of the Sherman Act, the keystones of our antitrust laws.

Competition in long distance services will remain in a vulnerable embryonic stage until companies, like U.S. Sprint, who are constructing their own facilities for provision of interLATA services, complete their projects and until all convertible BOC customer lines have been fully converted to equal access, BOCs no longer have control of bottleneck facilities and there is substantial competition in local telecommunications services. These conditions are not likely to be satisfied for years. Only then will emerging competitors be free from dependency upon AT&T and BOC facilities and essential governmental oversight and transition. Premature easing or elimination of restrictions on BOC entry into interLATA market, as well as in certain other markets, would be devastating to competition.

Judge Greene stated in his July 26, 1984 Opinion that he would not even consider the substantive merits of BOC waiver requests to provide interexchange services until the BOCs lose their bottleneck monopolies and there is substantial competition in the provision of local telecommunications services. More compelling considerations apply to BOC entry into the domestic information services markets and to a lesser extent in the equipment manufacturing/distribution markets. No significant changes have occurred in these markets to justify relaxation of the MFJ restrictions. In fact, the "equal access" applicable to information services in the form of comparably efficient interconnection ("CEI") and Open Network Architecture ("ONA") are in substantially earlier stages of development than is true for "equal access" in the long distance market. CEI and ONA have not yet been defined and have not been implemented with respect to any information service in any market.

As stated, there are certain basic conditions that must be met before the FCC should be permitted to grant any line of business waivers. We view adoption of these safeguards as both practical and essential if competition is to endure. Further safeguards, such as continuing Congressional and FCC oversight and public input into the process, will also help ensure that Congressional policy is implemented, as intended. But the better approach, as fully explained, would be to leave administration to the antitrust Court with both DOJ and FCC participation.

In summary, we believe that:

National telecommunications policy should be primarily determined by Congress, implemented by the FCC as a delegated policymaker, and a reflection of many public interest considerations, including maintaining stability and fostering competition;

National telecommunications policy can be better devised if Congress first has the benefit of FCC determination and disclosue of a comprehensive transition plan;

Serious threshold legal issues must be resolved before any further consideration of changing the forum for administration of the Decrees;

A better approach than forum change for assuring consideration of broad public interest concerns would entail FCC and DOJ submissions to the Judiciary consistent with the Tunney Act;

Competition in long distance telecommunications services is in a vulnerable embryonic stage requiring governmental oversight and transition extending for years;

Specific Congressionally-determined criteria, safeguards and restrictions are essential if FCC administration of the Decrees is to follow; and

BOCs should be foreclosed from entry into the long distance interLATA market pending elimination of BOC bottleneck controls and dominance of local exchange markets;

We have sought to make our testimony constructive. You and your respective staffs are welcome to call on us for further information, analysis or assistance as your inquiry progresses. We applaud your diligence and the open, objective manner in which you are proceeding.

STATEMENT OF THE FLORIDA PUBLIC SERVICE COMMISSION

The Florida Public Service Commission (FPSC) would like to thank Chairman Danforth and the entire Committee for the opportunity to present testimony on S. 2565. The FPSC agrees that the long term regulation of the Bell and General systems can not remain with the Department of Justice. Nor can enforcement of the policy goals of the Modified Final Judgment (MFJ). The Federal Communications Commission (FCC) is probably the best agency for enforcing the provisions of the MFJ and determining long term national telecommunications policy in today's rapidly changing telecommunications industry. This Commission can not, however, support or endorse at this time the bill sponsored by Senator Dole. This position is necessitated by what we believe are some very important issues not addressed in the legislation. Those issues are the basis of this testimony.

The FPSC shares Chairman Danforth's concern, as he stated at the first day of hearings, that once the FCC receives the degree of jurisdiction contemplated in S. 2565, congressional oversight, for all particular purposes, would be ineffective. To paraphrase Chairman Danforth's comments, if there is not a specific process which would incorporate some type of check on FCC action, that agency will do basically what it wants and will be unresponsive to outside concerns.

The FPSC believes that such a process as desired by Chairman Danforth and other members of Congress does exist. At the second day of hearings, the National Association of Utility Commissioners (NARUC) presented testimony which proposed the implementation of a joint board system. Joint boards, comprised of FCC and state commissioners are presently being used with great success at the FCC to address specific regulatory issues. A case in point is the joint board action in 1984 which effectively defused the politically "hot" access charge issue. The joint board process would provide the balance sought by the Committee in the administration of the intricate issues addressed by this legislation. The FPSC respectfully asks this Committee to establish such a federal-state joint board procedure as part of S. 2565.

Another concern of the FPSC is the respective jurisdictions of the FCC and the individual states under the legislation. The legislation is silent on this issue and this silence, can be interpreted as a complete federal preemption of the enforcement of the MFJ. This Commission is extremely concerned that a federal mechanism is being established by this legislation which will have great impact on local and long distance rates paid by the citizens of our state, as well as the telecommunication services those citizens will receive, but will deny this commission any participation in the determination of such issues due to this preemption.

The FPSC hopes that such a preemption is neither the intent nor the desire of Congress. Consolidation under the FCC of the enforcement of the MFJ should not be accomplished at such a great price. To ensure that state commissions retain the ability to actively enforce those aspects of the MFJ which are within the jurisdiction of the states, the FPSC strongly endorses and supports the position that this legislation should be made a part of the Telecommunications Act of 1934 (Act). By doing so, the provisions of the Act and the established caselaw would then apply.

Of critical importance to this Commission is the applicabilty of §152 of the Act. This section delineates federal-state jurisdiction over the telecommunications industry and specifically establishes state jurisdictional parameters. This dual federal-state regulatory system was recently upheld in the landmark United States Supreme Court decision in *Louisiana Public Service Commission* v. *FCC*, 90 L. Ed 2d 369. If S. 2565 is purely a procedural bill as its sponsors contend, inclusion within the Act would retain the regulatory status quo of the telecommunications industry with the transfer from the Department of Justice to the FCC the only change. This Commission strongly believes that this dual regulatory system must be included in S. 2565 if state commissions are to have any viable role, either now or in the future, in the regulation of the telecommunications industry in their respective states. The preservation of state authority in intrastate matters is also part of the "check" on FCC action previously discussed. Failure to continue this dual system could result in the FCC single handedly regulating the communications industry at both the federal and state level.

Another issue not addressed in this legislation is ratepayer protection. The FPSC believes that such protection should be included. As an example, if the FCC would lift the line of business restrictions and allow local exchange companies to provide additional nonregulated services, it is important that the captive local ratepayers do not subsidize such services. A section in the legislation addressing ratepayer protection would ensure that this and other inequities would not occur.

The FPSC is not alone in its belief that ratepayer protection is an important aspect of this legislation. Congressman Al Swift in his testimony before this Committee indicated his belief that such protection was necessary, and is developing a special ratepayer section to be included as an amendment to H.R. 3800. Congressman Swift commented, "I would commend [my special ratepayer section] to your attention as a blueprint for action to protect ratepayers should the Senate decide to move similar legislation". The FPSC joins Congressman Swift in this position and encourages this Committee to include specific ratepayer protection provisions in S.R. 2565.

In concluding this testimony, the FPSC would like to restate it's position that it does not support or oppose S.R. 2565 at this time. The concerns raised in the Commission's testimony are issues which the Commission believes must be addressed if this legislation is to adequately and properly provide for the transfer of enforcement of the MFJ to the FCC. In filing this testimony, however, the FPSC also supports the comments made by several committee members that consideration of this legislation not be conducted hastily. The FPSC understands Senator Dole's desire to have his legislation acted on before the end of the year. It is important, however, to realize that this legislation will be instrumental in establishing the direction and future of the telecommunications industry in this country. It is imperative, therefore, that this legislation be given the most intense congressional scrutiny possible.

This concludes the written testimony submitted this date by the FPSC. The FPSC would again like to thank Chairman Danforth and the Committee on Commerce, Science, and Transportation for this opportunity to comment on SR 2565.

STATEMENT OF ROBERT H. FAY, PRESIDENT, NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

INTRODUCTION

The National Telephone Cooperative Association (NTCA) is a national trade association which represents more than 450 small, independent cooperative and commercial telephone companies throughout rural America. We serve millions of subscribers in some of the most high-cost, sparsely populated areas of the nation. Our goal is to ensure that rural Americans receive telecommunications services on par with those available to urban residents.

NTCA's member telephone systems were not a party to the divestiture agreement. However, we would like to share our concerns about proposed legislation which would transfer authority to enforce the divestiture decree from the federal district courts to the Federal Communications Commission (FCC). Specifically, we ask the Committee to ensure that such a transfer would not lead to: (1) geographic toll rate deaveraging; and, (2) a return to the pre-divestiture captive monopoly supplier situation which impaired independent companies' access to equipment.

Toll rate averaging

The concept of universal telephone service is embodied in Section 1 of the Communications Act of 1934. Congress created the Federal Communications Commission to regulate "interstate and foreign commerce in communication . . . so as to make available, so far as possible to *all* the people of the United States a rapid, efficient, nation-wide and world-wide wire and radio communication service with *adequate* facilities at *reasonable* charges . . ." 47 U.S.C. 151. (*Emphasis* added).

National uniform toll rates have come to be recognized as a cornerstone of universal telephone service. Averaged toll rates keep long distance service affordable in sparsely populated areas of the country and encourage rural subscribers to utilize the national telephone network.

It has long been the Commission's policy to encourage the use of uniform averaged rates for long distance calls of equal distance, duration and class, as a means of ensuring universal service. In September, 1985, Chairman Fowler testified before his Committee on long distance competition and reiterated his commitment to toll rate averaging. He stated that as long as he was Chairman that policy would not change.

Congress has long recognized the importance of toll rate averaging in maintaining universal telephone service. Earlier this year several Bell companies proposed their own alternatives to the Access Charge Decision for the recovery of non-traffic sensitive costs. These plans would have geographically deaveraged the carrier common line charge, thus putting pressure on long distance companies to deaverage toll rates. Due in great part to congressional influence, the FCC disapproved these plans. Senator John Danforth voiced concern[1] about the effect of deaveraging on small telephone companies and competition in the long distance service market in general. He stated his support for the policy of nationally averaged rates and warned that deaveraging "would represent a shift in telecommunications policy that Congress would find unacceptable."[2]

Congressman Tim Wirth and nine other Members also expressed reservations to Chairman Fowler about these plans, pointing out that "if acted upon in a piecemeal, random manner the interaction of the individual plans could have a wide ranging and harmful effect on all consumers. . ."[3] One of the "harmful effects" they cited was geographic toll rate deaveraging.

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[1] Letter from Senator Danforth to FCC Chairman Mark Fowler, March 26, 1986.

[2] *Id.* p. 2.

[3] Letter from Congressman Wirth, *et al.* to FCC Chairman Mark Fowler, March 23, 1986.

Finally, the telephone industry itself supports toll rate averaging. In the Unity 1A Agreement, filed in July with the Joint Board, the local carriers agreed to: "Continue support for nationwide uniform toll rates through a long term support structure which limits geographically based deaveraging and by appropriate regulatory oversight."[4]

We believe that the policy of averaged toll rates would be threatened if the authority to enforce the divestiture decree is shifted from the Court to the FCC. If the Commission assumes the decisionmaking authority presently held by Judge Greene, it is increasingly likely that the Bell companies would enter the inter-LATA toll business. Our concern is that each Bell company would be likely to have its own toll schedule, which would increase the pressure on AT&T to deaverage toll rates.

Geographic toll rate deaveraging poses a threat to universal telephone service. Deaveraging rates based on the actual cost of a particular call route would result in rural rates which are substantially higher than those between equivalent distanced urban service areas. Higher rates could result in fewer long distance calls, a decline in toll revenue and an increase in local rates to offset reduced revenue. If local service charges become too high, subscribers would be forced to drop off the network.

This problem is compounded by the fact that rural subscribers are more dependent on long distance service to reach essential services such as hospitals and schools. Rural users also have smaller local calling areas with access to fewer telephones than urban subscribers.

Senator Danforth has proposed amendments to S. 2565 which are designed to protect consumers and competition and to require the FCC to consult with other expert agencies before allowing telephone companies to enter new markets. NTCA applauds the expansion and strengthening of the concept of universal telephone service to include preserving the "availability" of "affordable" telephone service. To ensure that a more competitive long distance market does not in fact weaken this concept, we request that Senator Danforth's amendment clarify the important relationship between universal telephone service and toll rate averaging. This could be done in one of three ways:

(1) After Section B in the "Findings" Section, bill language could be added: Toll rate averaging is the cornerstone of universally available and affordable telephone service and shall be maintained. or: Geographic toll rate deaveraging undermines the preservation of universally available and affordable telephone service and shall be prohibited.

(2) The report accompanying the bill could state Congress' desire to maintain geographically averaged toll rates to enhance universal telephone service.

(3) With respect to the public interest determination outlined in Section II C, the following bill language could be included: In considering the potential effects on universal affordable telephone access and usage, the FCC shall analyze the impact of its decisions on the maintenance of geographically averaged toll rates.

At the Senate Commerce Committee hearing on September 10, 1986, Chairman Fowler told the Committee that if jurisdiction over the MFJ were shifted to the FCC, he would adhere to congressional policy guidelines governing such a move. The above language is an excellent example of policy that Congress could adopt to protect ratepayers and ensure universal telephone service.

Telephone equipment manufacturing

In the pre-divestiture era, the Bell system had a "Bell only" manufacturing policy. That is, it directed its manufacturing arm, Western Electric, to sell equipment to the Bell system only, thereby excluding sales to the independent telephone companies and reducing competition.

NICA is concerned that allowing the Bell companies back in to the business of telephone equipment manufacturing could under certain circumstances, lead to a return to the captive monopoly supplier situation that impaired independent companies' access to equipment.

We are confident that the Committee is aware of this issue and will seek assurances that history would not repeat itself if the Bell companies were allowed to reenter the equipment manufacturing business.

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[4] 1986 Unity 1A Agreement, p. 4, *In the Matter of MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket Nos. 78-72, 80-286, filed July 25, 1986 by The National Rural Telecom Association (NRTA), National Telephone Cooperative Association (NTCA), Organization for the Protection and Advancement of Small Telephone Companies (OPASTCO), and United States Telephone Association (USTA).

Conclusion

Toll rate averaging is inextricably linked to the maintenance of universal telephone service. Without averaged toll rates, costs for local phone serice, especially in sparsely populated areas, could rise to unaffordable levels and, in turn, force subscribers to abandon telephone service. A disparity between rural and urban rates seems inconsistent with the Communications Act of 1934 which envisions a nationwide, uniform communications system. To prevent this from happening, we urge the Committee to take appropriate steps to ensure the continuance of geographic toll rate averaging.

STATEMENT OF PAUL L. GIOIA, CHAIRMAN, NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE

On behalf of the New York State Department of Public Service, I strongly oppose any legislation that would grant the Federal Communications Commission (FCC) primary authority to lift consent-decree restrictions currently imposed on Bell Operating Companies' (BOCs) activities. Such a measure, without safeguarding equivalent and comparable state jurisdiction over the instrastate activities of such companies, would be a radical and unwise departure from the system of dual regulation over communications matters that has prevailed for over half a century.

As you know, S. 2565 would transfer to the FCC the authority Judge Harold Greene now exercises to waive prohibitions contained in Section II D of the Modified Final Judgment. That Section prohibits the BOCs from (1) providing interexchange telecommunications services or information services, (2) manufacturing telecommunications products or CPE, or (3) providing any other product or service except exchange telecommunications and access service that is not a natural monopoly service actually regulated by tariff.

S. 2565 accomplishes this transfer of authority by requiring the FCC to promulgate the substance of the MFJ and the GTE consent decree as a Commission regulation. Thus, under S. 2565, the FCC would bar the BOCs from conducting any of the above-noted activities, unless they are able to make a showing to the Commission "that there is no substantial possibility that [they] could use [their] monopoly power to impede competition in the market [they seek] to enter." That showing, under current law, must be made to Judge Greene.

S. 2565 could be interpreted to undermine the system of dual federal/state regulation that Congress put in place over fifty-years ago. That dual regulatory structure, recently affirmed by the United States Supreme court in the case of *Louisiana Public Service Commission* v. *FCC*, has been an eminently successful one. It has produced the most modern, efficient telecommunications network in the world. At the same time it has provided basic telephone service at affordable rates, thereby making the goal of universal service a reality.

Continuing to protect state regulators' ability to oversee the local activities of local phone companies can only serve to enhance these accomplishments. Failing to protect the authority of state regulators, on the other hand, could significantly weaken our first line of defense against erosion of those universal service gains.

The dual federal/state regulatory system to which I have referred was codified by Congress in the Communications Act of 1934. In that Act Congress created a new federal agency to regulate the interstate telecommunications market, the FCC. Up until that time, the industry had technically been under the regulatory control of the Interstate Commerce Commission, but that agency, preoccupied with its responsibilities over the railroad industry, devoted little if any time or energy to overseeing the provision of communications services. Instead, that regulation was essentially left to the states. In the late 1920's and early 1930's, Congress initiated its efforts to structure a federal telecommunications regulatory agency. Early attempts floundered, however, because of Congress' inability to come to terms with the issue of dividing regulatory authority between the states and the new federal agency to be created.

Finally, in the 1934 legislation, the matter was successfully addressed to the satisfaction of all parties. The states would continue to regulate all matters relating to intrastate communications and the federal agency would regulate all matters relating to interstate communication. This arrangement was codified in Section 152 of the Communications Act. Section 152(a) of the Act states the Act's applicability to all interstate and foregin communication by wire or radio. Section 152(b) then reserves to the states regulatory authority over intrastate communication. In particular, Section 152(b) states, "nothing in this act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service of any carrier."

In recent years, the scope of Section 152(b)'s reservation of power to the states has been the subject of considerable controversy between the states and the FCC. That debate was largely resolved by the recent decision of the Supreme Court in *Louisiana Public Service Commission* v. *FCC*, 106 S.Ct. 1890 (1986). In that case the FCC had sought to preempt state utility commissions' setting of depreciation rates for intrastate ratemaking purposes. The FCC argued that one set of depreciation rates should be applied to facilities used jointly for inter and intrastate communications. To permit states to depreciate that property differently than was permitted in the intersate jurisdiction, the FCC contended, would frustrate achievement of its interstate depreciation goals and its general goal of making available a rapid, efficient nationwide communications system.

The Supreme Court rejected this argument. It held, as the states had argued, that Section 152(b) "fences off from FCC reach or regulation intrastate matters—indeed including matters 'in connection with' intrastate service." To the extent federal and state regulators' policy judgments differed, the Court held, Congress did not intend for state regulation to be preempted. Instead, Congress intended for the FCC to pursue its goals within the confines of a dual regulatory structure which incorporated the exercise of local regulatory expertise over the local activities of communications service providers. As the Court indicated in the *Louisiana* decision, sections of the Act granting jurisdiction to both the FCC and state commissions "are naturally reconcilable to define a national goal of the creation of a rapid and efficient phone service, and to enact a dual regulatory system to achieve that goal." Just recently, the D.C. Circuit Court of Appeals, relying on the *Louisiana* decision, rejected a similar effort by the FCC to bar state regulation of the entry of radio common carriers into intrastate markets.

S. 2565, if it is interpreted to override the provisions of Section 152(b), would turn this dual regulatory structure on its head with respect to activities currently the subject of the consent decrees. It would tear down the fence that Congress so carefully constructed. And it would place in the hands of federal regulators issues that are essentially local in character. Thus, a federal agency would decide whether a local telephone company should be permitted to provide interLATA services within a state. Yet under the existing statutory scheme, decisions with respect to intrastate telecommunications services are made by state regulators. That policy had worked well and should be continued.

It has been said, indeed it was said during the Louisiana court proceedings, that because of their interests in assuring that local rates are not unduly increased, state regulators cannot be trusted to make determinations about intrastate communications policy matters that also affect federal communications policy. I respectfully submit, Mr. Chairman, that affordable local service rates are as much a part of assuring the universal service goals of the Communications Act as is the issue of whether New York Telephone and other former BOCs should be permitted to provide intrastate interLATA service or to sell "widgets."

Several proposals have been made for a modified joint board approach to providing some state input into the waiver question. Under the proposed arrangement, a joint board composed of all five FCC Commissioners and four state commissioners would make a final determination as to whether a waiver should be granted.

Such an approach does not adequately protect state regulatory authority nor is it necessary as a matter of sound regulatory policy. A joint board approach is a reasonable one for achieving state regulatory input where a single unified determination with respect to jointly used jurisdictional property is necessary. This is true, for example, with respect to the separations process. As you may know, the separations process is the device used for assigning the costs of facilities used jointly for both interstate and intrastate communications to the respective jurisdictions for ratemaking purposes. That assignment is based on a rather complicated formula worked out over the years in part through a joint board process to avoid different federal/state cost allocations being made by each regulatory jurisdiction. Congress determined that in this situation it was reasonable to require a uniform judgment by a single, final arbiter. That final arbiter, according to the Communications Act, is the FCC, advised, but not bound, by a joint board comprised of both federal and state members.

Such an approach is not necessary or appropriate with respect to the waiver question. It is quite possible, for example, for the FCC to determine that on an interstate basis, sufficient competition exists to permit NYNEX to provide interstate interLATA service while the State of New York might determine that with respect to the local market sufficient competition does not exist and that therefore NYNEX's provision of intrastate interLATA service would not be in the public interest. It is true that these policies might rub up against each other to some extent, but it does not make achievement of the FCC's goal impossible. This is precisely the kind of tension the original framers of the Communications Act recognized would exist in a dual regulatory system, which, as the Supreme Court recently determined, Congress intended in order to ensure the exercise of state regulatory expertise over intrastate telecommunications services.

Similarly, the FCC might make a determination that the public interest would be served by a local telephone company's marketing "widgets" to customers in other states. But a primary concern in such a decision is that local ratepayers not be forced to subsidize this new enterprise. Clearly, the state commission's interest must be paramount and it, rather than the FCC, should have jurisdiction.

Judge Greene, as a matter of enforcement of the federal antittrust laws, currently preempts the states and the FCC with respect to waiver questions. While the states are not necessarily happy with this arrangement, it does not alter the traditional balance of power between the FCC and the states, because it is not an instance of federal telecommunications policy overriding state telecommunicatoins policy, but rather federal antitrust policy potentially overriding state and federal communications policy. According to well-settled principles, enforcement of the federal antitrust laws overrides the states' interest in setting intrastate telecommunications policy. And enforcement of those federal antitrust laws will continue. Thus, state commissions could not take action inconsistent with federal antitrust legislation. But transferring jurisdiction to the FCC would violate the long-standing federal policy in favor of state jurisdiction over intrastate telecommunications matters, a policy that was resoundingly reconfirmed by the Supreme Court in the recent Louisiana litigation.

To summarize, I do not consider the joint board approach to be a satisfactory substitute for state jurisdiction over intrastate issues. I favor instead, assuming that Judge Greene would no longer be acting upon these waiver requests, a continuation of the existing dual regulatory approach. The legislation should make it absolutely clear that no loss of state jurisdiction is intended.

Thus, the legislation should clarify that the FCC has authority over waiver requests only with respect to interstate communications matters and that the states retain jurisdiction with respect to intrastate communications matters. With respect to non-communications related waiver requests, for example a NYNEX request to sell "widgets", the legislation should give the FCC jurisdiction only to the extent that such activities would have an impact on interstate telecommunications services. And it should reserve to the states the authority they now possess to take regulatory steps necessary to protect their intrastate monopoly customers, whether that be, for example, by prohibiting the use of monopoly revenues for the promotion of the company's widget business, by requiring that the business be conducted through a separate subsidiary, or by requiring appropriate payments to the regulated entity. In this manner, both the federal interest in shaping the national telecommunications network and the state interest in protecting intrastate customers will be served.

The New York State Department of Public Service is not averse to reshaping the existing mechanism for communications policy-making with respect to BOC waiver requests. But we do oppose any measure that would radically depart from the current system of shared jurisdiction over communications policy matters. Until now the FCC and the states have had an equal partnership that has produced excellent results. I see no reason to undo that parternship. I look forward to working with the Committee in the future to shape legislation that would be beneficial to both the telephone network and to basic telephone subscribers. I thank the committee for this opportunity to present my views.

STATEMENT OF CARL E. HORN, SENIOR VICE PRESIDENT—CORPORATE STRATEGY, AMERITECH

My name is Carl E. Horn. I am Senior Vice President—corporate Strategy for American Information Technologies corporation ("Ameritech").[1] I testified before the House Subcommittee on Telecommunications, Consumer Protection and Finance of the Committee on Energy and Commerce in March of this year concerning the line-of-business restrictions imposed by the Modification of Final Judgment on the Bell operating companies. The purpose of my present statement is to discuss S. 2565, "The Federal Telecommunications Policy Act of 1986," and Senator Danforth's proposed amendments to S. 2565.

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[1] Ameritech is one of seven regional holding companies created by the divestiture of AT&T's local opeating companies on January 1, 1984. Ameritech provides exchange and exchange access services in the Midwest thorugh five wholly-owned subsidiary companies: Illinois Bell, Indiana Bell, Michigan Bell, Ohio Bell and Wisconsin Bell.

SUMMARY

Ameritech fully endorses the basic intent of S. 2565—to consolidate the regulation of telecommunications and the responsibility for this nation's telecommunications policy at the Federal Communications Commission. It makes no sense to continue the confusing, cumbersome arrangement that has divided responsibility among the Department of Justice, the Federal District Court, and the FCC. Only the Commission has the necessary resources, public interest perspective, and accountability to Congress to regulate telecommunications and to formulate public policy in a manner that is consistent, comprehensive, and responsive to all public concerns.

Ameritech also acknowledges Senator Danforth's concerns about the Commission's proper application of the public interest standard in administering the MFJ. Ameritech has, in numerous Commission proceedings, supported the principles and goals reflected in the proposed amendments. Thses include protection of ratepayers and competitors from unfair practices, reliance on economic analysis, and consulatation with Federal and state bodies. It is plainly appropriate for congress to direct the Commission to weigh these factors in the course of implementing the MFJ.

Providing guidelines for the Commission's decision-making process in S. 2565, rather than formulating definitive prescriptions and solutions, is a productive and useful endeavor for Congress. Growing competition, rapidly changing technology, and the consequences of divestiture have made today's telecommunicaitons markets very dynamic. Issues frequently are highly technical and complex, and the needs of the public and the various parties are multifaceted. Any specific solutions or prescriptions mandated by Congress, no matter how appropriate they might appear under current conditions, could quickly become outdated and even counterproductive. Instead, Congress should guide the Commission's process in administering the MFJ and then, through its on-going oversight processes, examine the quality and impact of the Commission's concrete analysis and implementation.

The issues S. 2565 addresses are vital to the future development of this country's communications infrastructure. Ameritech repeatedly has voiced its support for the basic concept of S. 2565 as introduced by Senator Dole, and we also acknowledge Senator Danforth's desire to refine the Commission's decision-making process. We respectfully ask that the proposed amendments to S. 2565 be clarified and modified in certain aspects (which I discuss later in this testimony), and urge that the Commerce Committee promptly and favorably report S. 2565, as amended, to the Senate for passage.

THE SIMPLE TRANSFER OF JURISDICTION IN S. 2565 SHOULD BE RETAINED

Ameritech first recommended shifting the forum for administration of the Modification of Final Judgment from the antitrust court to the FCC in comments submitted to this Committee on July 1, 1986, by William L. Weiss, Chairman and Chief Executive Officer of Ameritech. In Ameritech's view, regulatory oversight and policy development for the United States' telecommunications markets should be consolidated at the single organization that has the skills and accountability to carry out Congress's intent, the Federal Communications Commission.

By transferring the MFJ intact from the antitrust court to the FCC, Senator Dole's proposed legislation, S. 2565, would benefit the public through consolidation of regulatory responsibility for telecommunications policy at the FCC.

S. 2565 would benefit the public by consolidating regulatory authority at the commission

There are five fundamental reasons why S. 2565 would benefit the public. First, many public policy concerns raised by application of the antitrust decree most properly fall within the Commission's jurisdiction under the Communications Act of 1934. Consolidating decree administration at the Commission would avoid the confusion that results when the Court and the Commission arrive at conflicting determinations on important national telecommunications issues.[2]

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[2] This overlap in authority between the antitrust court and the Commission is particularly harmful to the rapidly-changing telecommunications industry. Neither its suppliers nor its cus-

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Second, the Commission has far greater resources than does the district court. Even the assistance of the Department of Justice is not sufficient to enable the Court to match the Commission's staff and expertise. Both the Court and the Department of Justice have acknowledged this fact.

Third, it is procedurally inappropriate for the Department of Justice, which filed the lawsuit that resulted in the MFJ, to participate in the Court's decision-making process. Although the Court has the ultimate right to reject the Department's waiver recommendations, the Department's ability to control the timing and characterization of all waiver requests gives it immense power over the waiver process.

Fourth, Congress has the ultimate responsibility for formulating national telecommunications policy. Because of Congress's accessibility to public viewpoints and dialogue, it is in the best position to assess the public's needs. While the district court has enforced the decree with vigor, the Federal judiciary is insulated from the Congressional process that should shape national telecommumnications policy. Congress, in turn, can implement its policy goals effectively through the Federal Communications Commission by means of its on-going oversight process.

Fifth, the legal standard applied by the Commission in carrying out its responsibilities—the public interest standard—is more comprehensive than the standard dictated by the antitrust laws. While the Court has demonstrated its sensitivity to certain factors that are essentially peripheral to antitrust concerns, such as ratepayers needs and national security, only the Commission is subject to a legal standard that mandates consideration of such important public interest matters.

Congress should not try to mandate specific prescriptions or solutions to MFJ issues in S. 2565

It is clear that S. 2565 would benefit the public and the telecommunications industry by consolidating day-to-day responsibility for national telecommunications policymaking at the place where it rightfully and logically belongs, the Federal Communications Commission. While some parties have expressed concern about Commission administration of the MFJ, those concerns easily can be allayed by adopting principles which would guide the Commission's deliberations. S. 2565, as amended, is thus a practical vehicle for achieving a highly desirable goal.

However, the value of S. 2565 seriously would be impaired if Congress were to try to use it to resolve specific MFJ issues. Telecommunications markets are changing far too rapidly, and the needs of the public and the industry are so multifaceted, that it would not be productive for Congress to attempt to legislate specific solutions to MFJ issues. The administrtion of the MFJ should be as flexible and dynamic as the myriad of forces that are shaping the industry.

Congress could guide the commission's administration of the MFJ through amendments to S. 2565

Ameritech believes that the basic guidance to the Commission reflected in Senator Danforth's proposed amendments to S. 2565 would help insure that the Commission properly weighs the public interest in administering the MFJ. Our concern about the proposed amendments is that they not be so prescriptive or inhibiting as to frustrate the highly desirable goal in S. 2565 of consolidating national telecommuications policymaking at the FCC. This goal would be frustrated, for example, if Congress were to give veto power over certain telecommunications issues to Federal agencies such as the Department of Justice, the FTC, or the Department of Commerce. Were that to happen, regulation of telecommunications quickly would become even more balkanized than it is today, with grave consequences for the development of a robust industry essential to this country's future.[3]

It would be unwieldy and perhaps counter-productive for Congress to attempt in the proposed amendments to take on the Commission's task of crafting particular definitions, procedures and solutions. The approach reflected in certain of the amendments, such as requiring the Commission to examine whether a carrier has "market dominance" without specifying a particular definition of market dominance, is a good example of a sensible approach. This demonstrates how the Committee can craft amendments which provide guidance to the Commission without becoming enmeshed in nuts and bolts specifics. Congress's use of such concepts gives

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tomers can make effective plans unless they receive consistent signals about telecommunications policy.

[3] The undesirability of conferring a veto power on various Federal agencies does not mean, of course, that the FCC should not consult with and give full consideration to the pertinent views of any Federal or state body. Indeed, every agency of the Federal government currently has the right to appear before the Commission in any of its proceedings.

meaningful direction to the Commission's activities without embroiling it in the impossible task of legislating detailed aspects of the Commission's administration of the MFJ.

The area of accounting safeguards provides another good example of why Congress is better advised to provide guidelines for the Commission's deliberations rather than formulate its own specific prescriptions and solutions. Selecting appropriate accounting safeguards to protect ratepayers and competitors requires expert analysis from the accounting profession in general, and from specialists in accounting for telecommunications enterprises in particular. It also requires weighing the real costs involved in requiring certain auditing and accounting practices against the economic cost of the threats such practices are intended to detect or deter. These difficult but necessary tasks would impose a substantial burden on Congress, consuming far too much of its resources and time.

PROPOSED CONGRESSIONAL FINDINGS

Ameritech endorses the three Congressional findngs (referred to sometimes as objectives in the Committee's materials) which Senator Danforth has proposed as amendments to S. 2565: (1) access to the local telephone network at fair and reasonable prices; (2) preservation of universal availability of affordable telephone service; and (3) reliance on competition rather than government intervention as a regulator.

It would be desirable, however, to clarify the first two amendments. The first seems intended to encourage access to local networks by interexchange and information service carriers, while the second amendment apparently refers to the goal of preserving universal service for individual customers. If, on the other hand, both amendments are aimed at universal service for individual subscribers, they should be rewritten because they use different standards ("fair and reasonable rates" in the first finding as opposed to "affordable telephone service" in the second finding).

Ameritech is a strong and long-standing proponent of the goal of providing equal access to local exchange networks for interexchange carriers and information service providers.[4] We support the Commission's efforts to ensure equal access to local exchange networks.

Concerning Senator Danforth's second proposed finding, Ameritech wholeheartedly supports universal service for local customers.[5] The Ameritech operating companies helped make universal service a reality, and we have not backed off on our commitment to this goal one iota. On the contrary, promoting access to and use of the local exchange network is and will continue to be the lifeblood of our core business.

Today, more than 92 percent of American homes have telephone service, according to Federal census data. In the Ameritech region, the figure exceeds the national level, and it remains stable. This should allay concerns that current service is in jeopardy. Massive local service cost increases simply have not occurred in our region. Midwest customers are not being forced to give up telephone service.

Basic local telephone service prices in the Ameritech region have increased less than 5 percent, on average, each year since 1984, not counting the Federal subscriber line charge, and telephone service remains affordable.

Today, residential customers of the Ameritech companies can obtain local service for as little as $5 to $10 per month including the Federal subscriber line charge. We feel that's an affordable amount and a bargain by any standard.

But my illustration does not stop with basic service. Well-documented findings have shown net savings for those customers who have taken advantage of lower-cost service options and the wider choices brought about by divestiture and increased competition.

Widely available service, a range of options and affordable prices is the true story of telephone service following divestiture—at least in the Ameritech region. In light of these facts, Ameritech also supports the third proposed finding, which endorses the role of competition. Through its Competitive Carrier proceeding and its deregulation of CPE and enhanced services, the Commission has relied vigorously on competition as a means of insuring efficient markets. Reliance on competition should be the touchstone of the Commission's administration of the MFJ. We have endorsed consistently the need for competition in the industry. We only ask that we also be allowed to compete so that more efficiency and options can be brought to consumers.

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[4] The Commission's access charge plan (CC Docket No. 78-72, *MTS and WATS Market Structure*, affirmed, *NARUC* v. *FCC*, D.C. Cir. No. 83-1225), requires that all interexchange carriers receive ubiquitous and non-discriminatory access to local telephone networks.

[5] The second proposed finding could be improved by rewording it to state that the goal of universal service is not intended to preclude consideration of other factors, such as national security.

Based on our understanding of the proposed findings, and our recommendations set forth above, Ameritech supports the three findings contained in Senator Danforth's proposed amendments.

PETITIONS FOR WAIVER, MODIFICATION OR ELIMINATION OF CURRENT MFJ RESTRICTIONS

Ameritech supports the imposition of mandatory time limits for consideration of proposed MFJ waivers. While most waiver requests should take no more than three to six months for action, the Commission should be permitted to take up to one year, where necessary.

Because the committee should not go beyond directing the commission to consider certain factors, it should decline to recommend specific solutions to MFJ issues

In the exercise of its legislative responsibilities, the Committee will want to use its oversight process to examine how the Commission has followed Congress's directives in S. 2565. However, it is unrealistic to expect the Committee to substitute for the Commission in formulating concrete answers to these ever-changing comples and difficult matters.

For example, the Department of Justice and the Federal Trade Commission have expended great effort over the years in generating detailed definitions of unfair trade, anticompetitive vertical and horizontal acquisitions, definitions of relevant markets, etc. Despite the substantial resources invested by the Department and the FTC to this effort, their definitions have changed frequently and show no signs of becoming stable. This experience strongly suggests it is not realistic to expect Congress to successfully craft permanent definitions for these concepts as they apply in the highly dynamic telecommunications industry.

FCC REGULATIONS

Ameritech shares Senator Danforth's concerns for protecting ratepayers from the financial consequences of the BOCs' involvement in new lines-of-business, and for protecting competitors from inappropriate cross-subsidies. The Commission has deliberated these matters at length in its Computer II and Computer III proceedings, and in its current proposal to change accounting rules.

It is unnecessary for Congress to go beyond general directives to the Commission in these areas by trying to enact specific accounting and auditing safeguards for the highly technical and rapdily-changing telecommunications markets. Congress should direct the Commission to give full consideration to the appropriate public interest factors in its decision-making, and rely on judicial review and its oversight process to examine and guide the Commission's specific implementation of these considerations.

ANTITRUST ENFORCEMENT

Following enactment of S. 2565, the Department of Justice and the Federal Trade Commission would retain the same ability to investigate anticompetitive activities that they possess under current law. The only difference is they would appear before the Commission instead of the antitrust court concerning any matters falling unde the MFJ.

Electronic publishing and the information services restriction of the MFJ

Among the MFJ provisions which S. 2565 would transfer intact to the FCC is the MFJ's prohibition against any BOC participation in information services. Some parties oppose entrusting the Commission with this jurisdiction. They contend the Commission is likely to modify the information services restriction in a manner that would permit the BOCs to monopolize electronic publishing.

These concerns are entirely misplaced. Ameritech's goal is to be able to provide delivery services (including protocol processing) and business support functions (including billing and similar services) to unaffiliated information service providers, and thus help them in building strong relationships with their customers.

Ameritech's provision of such functions poses no threat to the large enterprises which currently offer electronic publishing over dedicated facilities, and it would open up the electronic publishing market to new providers serving smaller, less lucrative markets. Instead of discouraging a "diversity of viewpoints," provision of these access functions by the BOCs would make more viewpoints available to a broader range of Americans, and not just the few who can afford expensive dedicated facilities.[6]

The opponents of S. 2565 who contend that the BOCs would strive to create their own data bases are ignoring the critical fact that the BOCs have no experience or special skills in producing or maketing data bases other than their traditional "information service"—the Yellow Pages. Obviously, it would be inconsistent with the intent of the antitrust court to prevent the BOCs from distributing their Yellow Pages service via the same information access services they seek to provide other parties. The antitrust court allowed the BOCs to retain Yellow Pages service in order to continue its financial contribution to the cost of local service. Yellow Pages service would inevitably become non-competitive, and thus non-compensatory, if the BOCs were not permitted to provide this service via the same access functions made available to services which compete with Yellow Pages.

CONCLUSIONS

Ameritech supports Senator Dole's bill, S. 2565, "The Federal Telecommunications Policy Act of 1986." Ameritech also recommends that the proposed amendments be modified as we have suggested, and that the bill, as amended, be favorably reported to the Senate for passage in this Session of Congress.

STATEMENT OF DESMOND F. HUDSON, PRESIDENT, NORTHERN TELECOM INC.

My name is Desmond F. Hudson. I am president of Northern Telecom Inc.

My purpose in submitting this testimony is to endorse the concept that responsibility for administering the AT&T divestiture decree should be transferred to the Federal Communications Commission.

Before detailing my reasons for endorsing this concept, let me describe my company.

NORTHERN TELECOM NOT A 'NICHE PLAYER'

Northern Telecom is the nation's second largest maker of telecommunications equipment—second in size only to AT&T Technologies, previously known as Western Electric. It has more than 20,000 employees in the U.S. in plants and research and development centers throughout the country. The corporation's U.S. operations, which are headquartered in Nashville, Tennessee, produced revenues last year of $2.9 billion. Almost all of those revenues were generated by sales of products manufactured by Northern Telecom in the U.S. What the company sells here, it makes here!

Northern Telecom is perhaps best known for having been a pioneer of the technology that's driving American society to an Information Age. That technology involves the application of digital electronics to the switching and transmission of telecommunications signals—be they voice, data, video, graphics, or any other forms of information. But Northern Telecom is more than just the pioneer of fully digital telecommunications systems.

It is a leading producer of virtually all the kinds of devices that connect to the public switched network; from simple single-line telephone sets to modern, integrated voice-data terminals, and large private switchboard systems. Northern Telecom is also a leading producer of almost all the different kinds of components that fit within the public network: outside plant equipment, testing equipment, switching, and transmission systems. About the only communications equipment my company doesn't make (and that's by design) are satellites and telephone poles.

From the most basic, black, rotary dial telephone sets to the most sophisticated of digital switching and transmission systems, in other words, Northern Telecom provides it all. Northern Telecom is *not* a niche player in this business.

Because of the depth and breadth of Northern Telecom's involvement in the U.S. telecommunications industry, I have a strong interest in how the AT&T divestiture decree is administered and in the policies driving that administration. I have an equally strong interest in the nation's communications policies, which are established by Congress and carried out by the FCC. My challenge in addressing communications and decree-related policies is not to protect my company's position in particular markets. Rather, it's to accurately read policy trends and make appropriate shifts of my company's resources.

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[6] In addition, by making it possible for more information service providers to enter the market place, we will stimulate traffic on our local networks, thereby benefiting all of our existing exchange and exchange access customers.

My purpose in submitting this testimony is consistent with this executive, resource-allocation responsibility: it's to seek a modicum of certainty and predictability in the public policy processes that dictate how communications goods and services are provided in this country. The mixed telecommunications policy signals coming from Washington these days are making it increasingly difficult for me to spend as wisely in the laboratory and in manufacturing as I think I could in a more predictable public policy environment. I am submitting this testimony in the hope that this confusion in policy might be reduced.

ANTITRUST, COMMUNICATIONS POLICIES CLASHING

In my view, enforcement of the nation's antitrust policies (as manifested by administration of the AT&T consent decree) is dangerously overlapping, and sometimes clashing with, execution of the nation's communications policies. As a result, confusion and uncertainty reign; technology is being artificially restrained, the development of new communications capabilities is being inhibited, and consumer choice is being restricted. Unless eliminated, this overlap will hinder America's international competitiveness, and negatively impact the nation's domestic economy and standard of living. In short, it will hold up our society's entry into the Information Age.

A good example of the kind of uncertainty of which I speak arose in May of this year when the FCC adopted its Computer III order, a decision that, for years to come, *should* influence how Americans gain access to sophisticated new communications capabilities. At any other time in the Commission's history—between its founding in 1934 and 1984, that is—this would have been regarded as a landmark decision. Yet the Computer III order cannot yet be regarded as such. At least not by those of us who have to plan and invest on the basis of it.

One reason for this is that nobody yet knows for sure how synonymous the terms "enhanced services" and "information services" are. "Enhanced services," of course, is the category of service offering that the FCC's proposed Computer III rules foresee Bell operating companies being allowed to provide on an integrated basis with regulated services. And "information services" is the category of service offering the consent decree bars the BOCs from providing.

That's how it's been going for over two years now. We get one signal from the FCC. Then we get not only a different one from the Department of Justice, but a different *kind* of signal, one that incorporates a vocabulary and set of rules foreign to those that have been in the making for the past half-century at the FCC.

What's needed to eliminate this kind of confusion—caused by the overlap of competing policies—is *not* a subjugation of one policy to another. What's needed, rather, is an assignment of responsibility for assessing the predominant nature of conflicts that arise in conjunction with administering the AT&T consent decree, and for resolving these conflicts—or reassigning responsibility for such resolution—in accordance with appropriate policy standards.

The Federal Communications Commission, in my view, is the logical institution to be assigned such responsibility. By virtue of its charter, its experience, and the safeguards that surround its processes, the FCC is prepared to design and execute measures in support of policies underlying both the Communications Act of 1934 *and* and AT&T consent decree.

Needless to say, some of the impediments to clear-cut communications policy—such as those thrown up by state regulators, appellate courts, and Congress—are necessary and intended components of a democratic society's policy making processes. The energy and effectiveness of the most important of the components of this nation's communications policy making processes, however, are being unintentionally inhibited by the Department of Justice. Ironically, the Justice Department is having this effect *not* as an enforcer of the nation's antitrust laws and policies, but rather as an agent of the Federal District Court Judge upon whose shoulders fell the awesome responsibility of overseeing fulfillment of the AT&T divestiture decree's terms.

GREENE TASK 'HERCULEAN'

The task of handling the AT&T antitrust case, its settlement, and its aftermath has, indeed, been Herculean. The speed and skill with which Judge Harold H. Greene has singlehandedly fulfilled it, and continues to do so, is an achievement of inestimable importance. It's an achievement about which the American public is probably insufficiently appreciative. Indeed, it warrants acknowledgment that, through his handling of the AT&T case, Judge Greene has earned himself a hallowed position not only in the annals of jurisprudence, but in those of American commerce and public policy, as well.

BILL WON'T DISTURB DECREE RESTRICTIONS

Among Judge Greene's most vital continuing tasks in this regard, needless to say, involves oversight of the consent decree's so-called line-of-business restrictions—the terms that keep the Bell companies out of manufacturing, "information services," and nationwide long-distance services. It is critically important, I feel, that this Committee, as well as my colleagues in the industry, realize that the legislation under consideration here will not disturb these restrictions. Quite the contrary, in fact.

By placing responsibility for the decree's administration in the hands of the FCC, Senator Dole's bill will assure that those restrictions are enforced, interpreted, and modified on as objective a basis as U.S. law can fashion. And that, of course, is because of the strict mandates imposed by the communications Act of 1934, the rigorous criteria of the Administrative Procedure Act, the constant specter of judicial appeal, regular Congressional oversight, and the thoroughly open opportunity for public participation in FCC proceedings.

Perhaps most troubling to me about the opposition to Senator Dole's proposal are the arguments being put forth about the FCC's inability—or worse, its unwillingness—to enforce the consent decree's line-of-business restrictions. Most prominent among these arguments is that the FCC is incapable of detecting discrimination, cross-subsidization, and other forms of anticompetitive behavior that may be engaged in by the Bell telephone companies. The argument is put forth that there never would have been an antitrust case against AT&T if the FCC was truly capable of carrying out the responsibilities given it by Congress.

Prior to divestiture, it was an understandably difficult task for the FCC—or anyone else— to measure AT&T's costs and accurately track their recovery. At least part of the reason for that difficulty was the monolithic nature of AT&T, what we then knew as the Bell System. Simply put, there was little or nothing against which to compare it. Today, thanks to divestiture, that is no longer the case. Now the Commission is in the historically enviable position of being able to compare the data of the telephone operations of the seven regional Bell Companies against one another. Major deviations reveal themselves prominantly, precipitate prompt investigation, and facilitate quick remedial action. Whatever shortcomings may have existed in the FCC's ability to monitor the telephone industry before divestiture, in other words, have all but been totally dissipated.

EVIDENCE OF FCC 'PREJUDGMENT' SPURIOUS

Another irksome argument being put forth in opposition to Senator Dole's proposal has the FCC's leadership prejudging the need for removal of the line-of-business restrictions. If, indeed, the FCC's chairman has prejudged issues being addressed by the Commission, then he is under an obligation, an ethical if not legal one, to recuse himself from participation in the resolution of such issues. I, for one, am totally unconvinced that Chairman Fowler or any of the other commissioners have prejudged any issues related to enforcement of the consent decree.

In my view, in fact, the FCC's commissioners are probably the five Washington policy makers least capable of arbitrarily doing away with the consent decree's proscriptions in an all-at-once, "flash-cut" sort of way. And that, of course, is because of the rigors of the FCC's own procedural rules, the strict criteria of the Administrative Procedure Act, the constant specter of judicial appeal, Congressional oversight, and public participation. Ample safeguards are in place to assure that nothing happen arbitrarily, capriciously, or in any other unreasonable way at the FCC. Those of us in the industry are aware—painfully so, at times—of how long it takes the FCC to adopt and effectuate new policies, but we recognize the legitimacy of the procedural safeguards that appropriately surround the agency's conduct.

FOWLER'S BUT ONE OF FIVE VOTES

There is one other factor that I think the committee should consider in measuring the pleas of those who say the FCC's chairman is prejudging consent decree issues. And that is this: Mark Fowler is but one of five commissioners. His is but one of five votes. How it is cast, furthermore, is greatly influenced by the deliberations and recommendations of dozens of professional FCC staffers—lawyers, economists, accountants, and engineers, virtually all of whom are dedicated to achieving the objectives that underlie the Commission's existence. Also, and as I mentioned before, Commission action is governed by the Administrative Procedure Act, a law that has established itself as an effective check against arbitrary, capricious, or otherwise unnecessarily ill-conceived regulation.

I find the arguments being made about the FCC's inability or unwillingness to uphold the provisions of the consent decree to border on hyperbole, and respectfully submit that they should be dismissed by this Committee on the basis of their purely spurious and conjectural nature.

As stated at the outset, the problem we are dealing with is the clashing of two important national policies. The enforcement of one is getting in the way of the enforcement of the other. the issue is a practical procedural one: how to resolve the substantive issues involved in administration of the consent decree in such a way as to reduce the clashing of these policies.

I feel that assignment of consent decree administration responsibility to the FCC is the "right" solution of this problem for two reasons. first, the commission is the proper agency for carrying out the nation's communications policies—it's the agency appointed by Congress to do that job. And second, the Commission—by virtue of competition supplanting monopoly as the preferred mechanism for achieving our national communications policy objectives and by virtue of legislative mandates to bar discrimination—is empowered and experienced at protecting against unfair competition.

FCC MOST OBJECTIVE FORUM

The alternative to Senator Dole's proposal would be to leave responsiblity for enforcing the consent decree with the Court's surrogate, the Department of Justice, which (1) does have responsibility for enforcing the nation's policies against unfair competition, but (2) does not have responsibility for carrying out the nation's communications policies.

In this regard, I cannot help wondering why some in my industry have been so quick to criticize Senator Dole's measure when certainly they must recognize that no forum other than the FCC can assure as objective an analysis of consent decree enforcement issues. The District Court overseeing the AT&T decree is not under the constraints that apply to the FCC, and could, virtually with the stroke of a pen, remove one or all of the line-of-business restrictions. It and the Justice Department could bring about such a result without giving the kind of public notice that must accompany FCC action, and without public participation of the kind that must accompany FCC proceedings. So, too, could this Congress unilaterally eliminate the consent decree restrictions. Indeed, legislation toward such an end has been introduced in the House of Representatives. And it's been cosponsored, I understand, by almost enough Members of Congress to pass the measure!

What the telecommunications industry needs—and what we are all striving for, those of us on *both* sides of the Dole bill—is a mechanism to assure the most objective analysis possible of issues that arise in conjunction with the consent decree's line-of-business restrictions. I believe Senator Dole's bill gives us a method for formulating and carrying out federal communications policy *and* for enforcing the terms of the AT&T consent decree in the most objective way possible, and in a way that provides the highest degree of public protection.

By transferring responsibility for enforcing the consent decree's terms to the agency to which congress has entrusted the nation's communications policy, the enactment of Senator Dole's bill will represent a giant step toward reducing the costly and time-consuming confusion that currently prevails among U.S. suppliers and users of communications equipment and services. The FCC will resolve communications policy related conflicts within its own rules, which, on account of Senator Dole's measure, will encompass the consent decree's terms. With the enactment of legislation of the kind proposed by Senator Dole the Congress will not only be reducing uncertainty, but you will be spurring innovation, speeding competition, and maximizing consumer choice. Further, you will drive employment in communications service and equipment-provisioning businesses to levels commensurate with demand in markets that are open and free—important ends of all U.S. public policy.

DOLE BILL NOT A 'QUICK FIX'

The deliberations over this legislation bring to mind some time-honored wisdom about the virtues and vices of getting all—or getting nothing—of what one wants in life. The wisdom, if I recall it correctly, holds that there are but two tragedies in life. The first is not getting anything of what one wants. The second, and most tragic of tragedies, is getting all of what one wants!

My industry friends on boths sides of this debate would do well, I suggest, to heed seriously this admonition.

If those favoring passage of this bill are assuming their position out of an expectation of a "quick fix," or hasty exit out from nder the consent decree prohibitions, then they would do well to reflect on the laboriousness of the FCC's procedures. History and law dictate that nothing occurs quickly at the FCC. And notwithstanding the alleged predilections of the current leadership there, nothing *does* happen precipitously at the FCC.

And those opposing passage of this measure out of an expectation that preservation of the consent decree's jurisdictional *status quo* will somehow isolate or protect them from new competition would do well to recognize the ease with which Judge Greene or this Congress can remove such protection. The consent decree restrictions—or the entire consent decree itself—can be vacated with a single stroke of the Judge's pen. For Judge Greene, there's no messy Administrative Procedure Act with which to contend: no time-consuming notices of proposed rulemakings, comments, reply comments, reports and orders, further notices of proposed rulemakings, and reconsideration actions. Just a stroke of the Judge's pen—judicial fiat, if you will—and the consent decree restrictions can all be gone. Needless to say, they could just as easily be vacated by Congressional fiat.

Those taking a position on this bill to achieve either "quick fixes" or to forestall competition should recognize the tragedy they are inviting—for themselves, for consumers, and for America's future.

I am not submitting this testimony to achieve a "quick fix" in which I would have a vested interest. Nor am I appearing to protect myself from oncoming competition. Rather, I'm here to endorse a right, correct, and rational approach to resolving the contradictory federal government decision-making processes that are wreaking havoc in the way Americans gain access to needed communications capabilities.

Senator Dole's proposal is the right solution to a difficult conflict, caused by the clashing of two important public policies. I commend this Committee's, and the Senate's, prompt and favorable consideration of it.

Thank you.

STATEMENT OF THE INDEPENDENT DATA COMMUNICATIONS MANUFACTURERS ASSOCIATION, INC.

SUMMARY

S. 2565 should not be amended; it should be tabled. Commerce Committee Chairman Danforth is correct in recognizing that the bill introduced by Senate Majority Leader Dole does not adequately protect ratepayers and competition, but under present circumstances it would be pointless to attempt to cure the deficiencies of this legislation by amendment. Congress should simply abandon its consideration of S. 2565 for this year.

The premise of the legislation is dubious, at best. S. 2565 would amend a judicial order by ousting a federal court of jurisdiction over an antitrust consent decree. The authority to determine whether (and under what circumstances) the Bell Operating Companies ("BOCs") should be permitted to engage in activities from which they now are prohibited would be stripped from a distinguished jurist of whose actions the BOCs have no reason to complain. Jurisdiction over the provisions of the Modification of Final Judgment ("MFJ") would be transferred to a regulatory agency which has already expressed its displeasure with the line-of-business limitations—even though it has not yet received any public comments addressing the issue.

At a minimum, Congress should defer any action involving the MFJ until 1987. The legislative agenda is crowded; there is little time remaining in the 99th Congress; and Senators and Representatives do not have time for careful study of the complex arguments for and against retention of the MFJ and preservation of the District Court's authority. Moreover, consideration of S. 2565 would interfere with the triennial review of the MFJ, a process which should be permitted to go forward without extraneous political pressure and which, if not affected by precipitous legislative action, is likely to produce a record that would greatly facilitate informed legislative decisionmaking should it later be determined to be necessary.

INTEREST OF IDCMA

IDCMA is a trade association of U.S.-based companies which manufacture high-technology equipment used in computer (data) communications. Together, IDCMA's members directly employ over 10,000 people, primarily in Alabama, California, Connecticut, Florida, and Massachusetts, but also elsewhere throughout the Nation. IDCMA's members typically export on the order of 30 percent of their output.

Most equipment produced by IDCMA members is used as customer-premises equipment ("CPE"), but some is also used by carriers in their regulated transmission networks. Most domestic users of the modems, multiplexers, network management systems, etc. produced by IDCMA members are Fortune 1000 companies, but many smaller companies are also developing substantial data communications requirements. Innovation in the "datacomm" equipment market is rapid, and competition is robust. Existing suppliers are meeting the needs of carriers and users alike.

IDCMA was formed in 1971 to promote fair competition in the data communications equipment marketplace. As independent companies, IDCMA members have labored long to eliminate impediments to fair competition established by those telecommunications common carriers which have affiliated equipment manufacturers. IDCMA has participated actively in numerous proceedings before the Federal Communications commission, has contributed constructively to congressional consideration of telecommunications issues, and has vigorously supported the Government's efforts to obtain a judicial remedy to persistent antitrust problems through the *United States* v. *AT&T* antitrust litigation.

DISCUSSION

IDCMA is at a loss to understand Congressional efforts to enact S. 2565 this year. Virtually everyone recognizes that the bill involves complex public policy considerations with significant long-term implications, and most members of Congress would concede that they have, at present, only a limited understanding of these issues. Congress should not legislate before it has had an opportunity for careful deliberation.

The 99th Congress has an ambitious agenda, and very little time to complete it. Numerous appropriations bills, a massive overhaul of the tax code, and international trade legislation are but a few of the important issues which remain to be addressed in the days remaining before adjournment sine die. Under these circumstances, there is no opportunity for the careful study and reasoned debate that is indispensable to prudent telecommunications legislation. Both the very brief time allowed for Commerce Committee hearings on this bill and the lack of participation by the Judiciary Committee in the process further underscore the impossibility of enacting responsible MFJ-related legislation in 1986.

Nonetheless, the BOCs seek to stampede the Congress into precipitous action. Why? Because their only chance to secure enactment of legislation such as S. 2565 is to incite action before legislators adequately understand what they are doing.

If Congress takes the time for careful study of this legislation, it will recognize that proposals to amend the MFJ or to transfer jurisdiction to another agency are utterly misguided. There are numerous reasons, but several warrant emphasis:

Growing competition in telecommunications equipment, CPE, long distance telephone service, and information services will be jeopardized.

Telephone ratepayers will pay inflated prices for essential transmission services to subsidize BOC diversification.

The FCC has not adequately protected ratepayers or competition, and it has already filed formal comments with the District Court urging the elimination of the line-of-business restrictions.

The independence of the judiciary will be compromised, and future antitrust violators will be encouraged to seek legislative relief from their negotiated consent agreements.

IDCMA discussed these and other issues in detail in comments submitted to the Commerce Committee on July 3 (copy attached). The overwhelming majority of other parties that filed comments in the "paper hearing" expressed similar views. In contrast, the BOCs presented strained arguments that amounted to little more that a plaintive plea to enjoy "the same freedoms as AT&T," but they are unwilling to pay the price that AT&T did: divestiture of its local bottleneck transmission facilities.

In their written submissions to the Committee, the BOCs did not explain away their antitrust problems of the past or demonstrate how a recurrence of those problems can be avoided if the MFJ's line-of-business limitations are relaxed. The BOCs did not identify any unfairness or impropriety in the administration of the MFJ by the U.S. District Court (Judge Greene has, in fact, approved all but one of the more-than-five dozen waiver requests so far adjudicated). The BOCs did not provide an honest accounting of their massive losses in their unregulated businesses (other than Yellow Pages) or of the enormous transfers of monopoly profits which are being used to subsidize their forays into new markets (the FCC has denied requests that it elicit this information). The BOCs did not explain why it is so important for Congress to legislate on the very eve of the triennial review process in which they will have a full opportunity to seek whatever changes they wish in the MFJ (to date, the BOCs have not even asked the Court to grant the relief which they expect the FCC to grant them if S. 2565 is approved).

In short, the BOCs have not addressed fundamental issues that warrant careful consideration before any legislation is enacted. Nor have they demonstrated any sound reason why Congress should address this issue at this time.

To be sure, if Congress does decide to legislate, it must devise sound measures to protect ratepayers and competitors against renewed anticompetitive conduct; the FCC cannot just be given a "blank check" or told only that it should be guided by the "public interest." After all, the Commission's view of what the public interest requires may well differ from that of the Congress, the Administration, various classes of telecommunications users, or other industry participants. Thus, to minimize the dangers of predatory conduct, any legislation that could permit the BOCs to engage in manufacturing of telecommunications equipment and CPE would need to include safeguards to address, inter alia, the following concerns:

BOCs have a unique knowledge of the characteristics of regulated tranmission facilities and forthcoming changes in the network. If BOC-affiliated manufacturers gain access to such network information before the same information is made available to independent manufacturers, competition will inevitably suffer.

In their provision of regulated transmission services,the BOCs acquire valuable information about their customers' communications requirements, traffic patterns, and future equipment needs. This information, too, can be extremely valuable to a manufacturer, and if such information is exploited to the BOCs' competitive benefit, they again will enjoy unearned advantages over their independent competitors.

In the past, the BOCs purchased equipment from their affiliated manufacturer regardless of whether better quality or better prices were offered by independent manufacturers. The inflated prices of the equipment purchased from their affiliates could be passed along to captive ratepayers through higher telephone bills. A recurrence of this type of conduct would put further pressure on local telephone rates, deny independent manufacturers a major outlet for their products, and limit the array of products available to the consumer.

To sell equipment to the BOCs, independent manufacturer must be prepared to reveal highly sensitive technical and financial information. If the BOCs themselves are competitors of independent manufacturers, such disclosures may be inhibited, or the information conveyed may be misused.

The BOCs can control the technical interoperation characteristics of their transmission services. They can easily ensure that the standards accommodate their own equipment, but not equipment produced by independent manufacturers.

The BOCs can control the timing, the geographic deployment, and the pricing of their transmission services. Any one of these may be manipulated to facilitate sales of their own equipment, or to forestall sales of their competitors' equipment.

The complexity of the issues extends beyond factors that affect the competitive environment and the welfare of telephone ratepayers. Other substantive and procedural issues must also be considered. For example, on a substantive plane, how should the legislation deal with the likelihood that successful domestic manufacturers would be displaced by offshore BOC operations, depriving Americans of desirable high technology jobs and worsening the Nation's balance of trade? From a procedural standpoint, what requirements should be established to address such issues as prejudgment, discovery, participation by all interested parties, and thorough judicial review of agency action?

At present, there is no consensus as to how any of the foregoing matters should be addressed. Indeed, even the Administration has not yet articulated its view as to whether the BOCs should be permitted to engage in any of the three major prohibited lines of business and, if so, what procedural and substantive safeguards should apply. Yet all of these issues must be considered, and a record developed, before the Congress can give prudent guidance to the Commission. And, even if there were a consensus as to how these issues should be resolved, drafting and refining the specific legislative language to achieve the desired results would consume weeks, and probably months.

Thus, there are insurmountable obstacles to the enactment of responsible telecommunications legislation this year. That being the case, what purpose is served by undertaking a legislative exercise during the time remaining in the 99th Congress? From the BOCs' perspective, the obvious answer is: approval of S. 2565 by the Senate, or even by the Commerce Committee alone, "sends a message" to Judge Greene. But this is not an appropriate legislative function. It is one thing to "send a message" to a regulatory agency which is, after all, a "creature of Congress." It is quite another thing altogether to "send a message" to the judiciary.

Congress can, of course, amend the laws, but the MFJ results from litigation under the Sherman Act and S. 2565 does not propose to amend the antitrust laws. Congress may not (and even if it could, it should not) amend a judicial decree or deprive the judiciary of power to enforce its judgments. Our constitutional scheme assumes that the judiciary is, and must be, independent. S. 2565 represents an assault on this independence, and even the consideration of this legislation at this time presents a significant risk of brining improper political influence into a pending judicial proceeding.

Representatives of IDCMA are willing to discuss the foregoing, or any other issues, with members of the Legislative Branch at any time. Nonetheless, IDCMA considers that the present environment—particularly as it concerns the legislative calendar and the pending triennial review of the MFJ—is not conducive to reasoned legislation. Under existing circumstances, S. 2565 should not be further considered.

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. Should the forum for administering the MFJ be changed? If so, what forum(s)— should have jurisdiction?

Answer. The forum for administering the MFJ should *not* be changed. Several points are relevant here.

1. The Decree can properly be administered only with a full understanding and appreciation of the anticompetitive conduct that made the Decree necessary. U.S. District Judge Harold Greene heard months of testimony and knows much better than anyone else the problems that gave rise to the Decree and the extent to which the BOCs retain the opportunities and the incentive to impede competition.

The MFJ is the product of two antitrust cases instituted by the United States: *United States* v. *Western Electric,* which was commenced in 1949 and settled with a consent decree in 1956, and *United States* v. *AT&T,* which began in 1974 and led to the MFJ in 1982. This litigation involved what are now eight major U.S. corporations which, although subject to the Communications Act of 1934, as amended, substantially affect numerous business which are not regulated under such Act. Accordingly, it was and is appropriate for the BOCs' activities to be addressed under the antitrust laws and in antitrust forums.

2. There are no good reasons why jurisdiction should be removed from the District Court.

The Court has been extraordinarily lenient in granting waivers of the MFJ's line-of-business restrictions. So far, more than 70 waivers have been granted. Only one has been denied.

the Court is required to grant additional waivers if the BOCs can demonstrate that there is no substantial possibility that they could impede competition in the markets they seek to enter. Where the Court erroneously to deny a waiver request, the petitioning BOC could redress the error through judicial review.

The Court soon will conduct a comprehensive review of the continuing need for the line-of-business limitations. The Justice and Commerce Departments are currently preparing reports that will lay the factual predicate for this review. The BOCs will participate fully in this process.

3. There are compelling reasons why jurisdiction should not be transferred away from the District Court.

Enactment of unprecedented "court-stripping" legislation would undermine the independence of the judiciary, contravene the purposes of the Tunney Act, and encourage past and future antitrust violators to seek political "relief" from judicial orders.

The judicial process is the best mechanism to ensure reasoned decisionmaking, with full participation of all interested parties and all relevant facts and considerations expressed openly on the public record.

A majority of the Commissioners at the FCC have already publicly expressed the view that the MFJ restrictions should be jettisoned, even though they have not been presented with the complete record needed for informed decision-making on this topic.

The crucial determination in the antitrust case, based on the testimony of two former chiefs of the FCC's Common Carrier Bureau and other experts on the regulatory process, was that "the Commission is not and never has been capable of effective enforcement of the laws" insofar as the Bell System is concerned. *United States* v. *AT&T,* 552 F. Supp. at 168. This conclusion was attributed to "structural, budgetary, and financial deficiencies within the FCC" as well as the resources and complexity of the Bell System companies. None of these problems have been eliminated; in fact, the obstacles to effective regulation are increasing.

Question. What criteria should be used in reviewing whether the MFJ restrictions are necessary? Should different criteria be used for reviewing different restrictions?

Answer. Section VIII(C) of the MFJ establishes the appropriate standard: "The restrictions imposed upon the separated BOCs . . . shall be removed upon a showing by the petitioning BOC that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter." This standard should be applied to all types of diversification proposals.

Use of this standard will, of course, produce different results in the case of different proposed ventures. There is little danger in allowing the BOCs to market real estate, for example, and they have been authorized to do so. There is substantial danger to competition in allowing a BOC to manufacture equipment that will be connected to the BOC's local exchange "bottleneck" or equipment that will be used in the network and therefore dictates interoperation characteristics for CPE. The likelihood of anticompetitive conduct is so great that the BOCs have not even attempted to make Section VIII(C) showing in the case of manufacturing for the domestic market.

Question. What effect would modification or removal of the restrictions have on labor?

Answer. Removal of the manufacturing restriction would substantially lessen equipment competition in U.S. markets and, as a consequence, make U.S. products less competitive in world markets. This, in turn, would cause the loss of U.S. jobs.

Question. How is the range of telecommunications products and services available to consumers affected by the restrictions?

Answer. The Decree establishes opportunities for numerous firms to compete vigorously with one another without fear of being destroyed by companies which control "bottleneck" transmission facilities and which possess the resources and the will to use their market power to gain unfair advantages over their smaller competitors. The natural consequence is that innovation and price competition are flourishing as never before, and consumers can now choose from a much greater array of equipment and service offerings.

Also, the BOCs now generally buy the best equipment available, selecting from thousands of products offered by hundreds of manufacturers. This arrangement delivers better quality service to the consumer than did the previous system, when the BOCs purchased equipment primarily from their affiliated manufacturer and independent manufacturers were foreclosed from this market.

Question. How are the prices and rates of telecommunications products and services affected by the restrictions?

Answer. As noted above, the competition made possible by the MFJ stimulates price competition as well as innovation. Prices for all types of CPE, ranging from simple telephones to 1.544 million-bit-per-second data units, have fallen rapidly and will continue to decline so long as a competitive environment is maintained.

Were the manufacturing restriction to be removed, the adverse effect on prices would be twofold. First, diminished CPE competition would mean diminished price competition. Second, the inevitable use of ratepayer funds to cross-subsidize the BOCs' CPE design and development would inflate the rates charged for basic telephone services.

Question. What trade implications would modification or removal of the restrictions have?

Answer. In the case of manufacturing, removal of the restriction would weaken the independent manufacturers who are highly successful exporters (IDCMA members, all of whom do their manufacturing in the United States, successfully export approximately 30 percent of their output). To the extent that independent manufacturers lose their domestic sale base to the BOCs, they will find it much more difficult to sustain the research and development and the economies of scale that permit them to export successfully. Meanwhile, the BOCs are likely to be very unsuccessful in their overseas endeavors, just as was the predivestiture Bell System. The net effect will be a worsening of the trade balance, especially if the BOCs' foreign manufacturing operations displace exports from domestic manufacturers.

Question. What effect would modification or removal or the restrictions have on completion?

Answer. As the attached paper discusses in detail, removal of the manufacturing restriction would imperil competition in CPE and telecommunications equipment manufacturing. There are numerous mechanisms by which the BOCs can compete unfairly in the manufacturing market: cross-subsidies; discrimination in the establishment of network standards; discrimination in the disclosure of network information; discrimination in the provision of essential transmission services; misuse of access to customer information; etc.

Whenever there is a sufficient change in circumstances that the BOCs' entry into the manufacturing business would not imperil competition, the Decree provides that the restriction must be removed.

Question. What safeguards, such as cost accounting requirements, structural separation, or congressional or regulatory oversight, should be put into place before restrictions are modified or removed? Would such safeguards be practical? Would they be effective?

Answer. There are so many different ways in which the BOCs could compete unfairly in equipment manufacturing that no set of alternative safeguards could suffice to prevent anticompetitive conduct were they permitted to engage in manufacturing. Separate subsidiaries do make anticompetitive conduct more difficult to accomplish and somewhat easier to detect, and the Court has determined that a separate subsidiary requirement is a sufficient safeguard in the case of activities (such as real estate marketing) which are not related to telecommunications. (Incidentally, it was the BOCs themselves that persuaded the District Court to adopt a separate subsidiary requirement, even though they have contended to the FCC that separate subsidiaries are inefficient and unnecessary).

Were the BOCs to be permitted to engage in manufacturing, detailed requirements would be needed to minimize the prospects of each of the different abuses described in the attached paper. At a minimum, these would include requirements for (1) complete structural separation of all CPE research, development, design, and fabrication activities and arm's-length dealings between regulated and unregulated activities, (2) comprehensive cost allocation rules governing both regulated and unregulated activities; (3) complete, prompt, and non-discriminatory disclosures of all network information which affects the interconnection or interoperation of CPE; (4) simultaneous disclosure to independent manufacturers of any customer information made available to the affiliated manufacturing entity, on the same terms and condition; (5) competitive procurement of products and services; and (6) a duty of fair dealing imposed on all employees of the regulated entity to ensure fair and nondiscriminatory treatment of unaffiliated manufacturers.

Of course, for any such scheme of behavioral regulation to have any chance of success, the agency charged with oversight would have to have substantial financial and personnel resources—and a will to use them. Unfortunately, the enactment of the Gramm-Rudman-Hollings constraints gives added weight to the District Court's concern that "[r]ecent developments in governmental policy point to a further reduction in the funding, the authority and hence the effectiveness of regulatory agencies such as the FCC." *United States* v. *AT&T*, 552 F. Supp. at 168 n. 157. Accordingly, a fair evaluation of the situation would cause one to seriously doubt if there is the capability of adequate enforcement.

Under the present circumstances, the BOCs present such a threat to competition in manufacturing that reliance on measures short of an absolute prohibition would be singularly inappropriate.

STATEMENT OF INTERNATIONAL BUSINESS MACHINES CORPORATION

International Business Machines Corporation ("IBM") has a keen interest in the development of America's increasingly interdependent information processing and telecommunications industries. IBM is a provider of telecommunications equipment, information services, and information processing equipment and is a large user of telecommunications services. For these reasons, it has participated for years in telecommunications policymaking proceedings in the Congress, at the Federal Communications Commission ("FCC"), and before other governmental agencies.

IBM agrees with the congressional finding proposed by chairman Danforth that, if the promise of the "information age" is to be fulfilled, the United States must continue to ensure that voice telephony is universally available, under appropriate regulation where effective competition is not feasible. At the same time, the United States should have as its compatible objective the promotion of innovation and efficiency in telecommunications. IBM believes that both objectives can best be achieved by relying on nonregulated competition wherever possible. Competition will promote the cost-consciousness of the dominant carriers, reduce prices, stimulate innovation, and generate a wider range of service alternatives.

To enable competition to provide these benefits most effectively, the dominant carriers should participate in nonregulated markets with appropriate safeguards to ensure that competitors are not unfairly disadvantaged and ratepayers are not burdened with inappropriate costs. Further, basic services should be opened up to competition where technology makes this feasible. Today, technology permits and regulations precludes competition in some basic services. Competition should be permitted, and once such services face effective competition, they should be deregulated. In the long run, deregulation can supplant safeguards as the means of assuring a healthy, competitive telecommunications marketplace. Competition in telecommunications markets will thus be best served by advancing on both fronts at once: As the dominant carriers are allowed to increase their participation in the nonregulated marketplace in accordance with established safeguards, the services under the former Bell Operating Companies' ("BOCs") exclusive control should be simultaneously reduced by allowing competition in basic services.

In his testimony before this Committee on September 10, 1986, FCC Chairman Fowler suggested that the Congress should reassert control over national telecommunications policy. If the Congress decides to adjust national policy in this area, it should give the FCC guidelines to follow in implementing that policy. IBM submits a number of recommendations concerning areas that merit congressional attention. Our recommendations have the common theme of reinforcing the national policy of reliance on competition in the provision of telecommunications and related goods and services.

First, Congress should reaffirm the need to establish and enforce effective nonstructural safeguards to prevent improper cross-subsidies and discrimination as the dominant carriers are allowed to participate in the competitive marketplace without structural separation of their competitive activies from their regulated common carrier operations. The FCC has established a format for developing effective nonstructural safeguards, but that process is not yet complete. These safeguards are essential for any corporate structure that combines both regulated and nonregulated activities and therefore creates incentives to engage in practices that harm the competitive marketplace.

Second, Congress should establish a *quid pro quo* for permitting the BOCs to enter additional nonregulated businesses: a reduction in the artificial barriers that prevent competitive entry by others into the basic service marketplace now dominated by the BOCs. The barriers to entry should drop on both sides at once, allowing the BOCs into telecommunications-related areas in which they have not previously participated and allowing new entrants to compete against the BOCs' basic services wherever competition is feasible. This quid pro quo will promote the development of innovative communications services and of new technologies, making competition feasible in more and more areas of telecommunications that may once have been considered natural monopolies. It also will reduce the inherent ability to discriminate in the provision of basic services, and, by shrinking regulated ratebases relative to competitive activities, it will reduce the potential for any improper cross-subsidization at the expense of the ratepayer.

Third, Congress should strenghten the FCC's ability to achieve these procompetitive objectives through legislation expressly reaffirming that the FCC has authority to preempt state regulation which would frustrate these objectives. The FCC has properly asserted its ultimate authority to preempt local regulations inconsistent with national telecommunications policy, but its preemption power has been clouded by recent court decisions. Congress should encourage the states, and give them the opportunity, to act consistently with the national policy of competition in telecommunications. At the same time, in giving the FCC explicit responsibility over the BOCs' entry into nonregulated businesses, Congress should also give the FCC the necessary authority to fulfill that responsibility.

Finally, Congress should give careful attention to the implications of domestic telecommunications decisions for international trade. Any action should be consistent with the special emphasis placed by the United States on open access and procurement policies. The United States, with the largest and most competitive telecommunications industry in the world, is the model for many other nations with which Americans do business. The FCC's recent proposal potentially to backtrack by reregulating certain products and services that are now nonregulated could adversely influence the trend toward liberalization elsewhere. Similar trade considerations should be taken into acocunt in effecting any elimination of the manufacturing restrictions on the BOCs. Congress should make clear that any new policies in this area are not intended to reduce access to the U.S. market for any supplier.

We discuss each category of recommendations more fully below.

I. EFFECTIVE NONSTRUCTURAL SAFEGUARDS

The FCC has over the last decade relied principally on structural separation to deter improper cross-subsidies and discrimination where the dominant common carriers engaged in nonregulated activities. However, in the last year the FCC has concluded that structural separation exacts too high a price in efficiency. It therefore has ruled in the AT&T Structural Relief Order and in the recent Computer III Order that the dominant carriers should be permitted greater operational flexibility.

The FCC is in the process of establishing nonstructural safeguards to take the place of structural separation in deterring and detecting abuses by dominant carriers'; control of regulated basic telecommunications facilities is not used to obtain unfair advantage in the nonregulated marketplace at the expense both of the regulated ratepayer and, ultimately, of the consumer of nonregulated products. Senator Danforth's Proposals solicit comments on such safeguards. We believe the following safeguards are essential:

A. A cost allocation and accounting plan to identify and fully distribute the costs associated respectively with the regulated and nonregulated business, in order to prevent improper cross-subsidies.

B. A requirement that carriers using underlying regulated services when offering their own nonregulated services account for such regulated services under tariffed rates and take them on the same terms as they are made available to noncarrier service providers.

C. Provisions for comparably efficient interconnection and, in the longer term, open network architecture to assure that competitors can gain equal access to and efficient use of the network.

D. Network information disclosure rules giving manufacturers and competitive service providers an equal opportunity to plan in advance to accommodate anticipated changes in the network interface.

E. Nondiscriminatory service procedures to ensure that subscribers who purchase competitors' equipment or services are not discriminated against in the installation and maintenance of basic network services.

F. Auditing and review procedures to test both the adequacy of carriers' compliance plans and the degree to which their practices conform to those plans.

Each of these safeguards is discussed in greater detail in Attachment A.

II. PROMOTING COMPETITION IN BASIC SERVICES

The need for nonstructural safeguards with respect to the BOCs and other dominant carriers stems from their control of regulated basic transmission services that are not subject to effective competition. The unavailability of effective substitutes for those services creates the potential for the anticompetitive practices the safeguards are intended to prevent. In addition, the carriers' ability to recover any costs assigned to their regulated operations (plus a regulated rate of return) from essentially "captive" ratepayers creates a source of potential improper cross-subsidies that are often difficult for state and federal regulators to detect. Such cross-subsidies unfairly burden the ratepayers and impede competition in the nonregulated marketplace, ultimately injuring users there as well.

Nonstructural safeguards can never entirely prevent anticompetitive practices as long as the opportunities and incentives to engage in the practices remain substantial. The ultimate solution is the market discipline that will be imposed by a telecommunications marketplace that is effectively competitive in basic services as well as in enhanced services and equipment.

Even the initial introduction of competition against the BOCs' basic services will promote greater cost-consciousness among the BOCs and drive basic service prices toward costs, reducing the carriers' ability improperly to cross-subsidize their nonregulated activities. And the subsequent deregulation of basic services as they become competitive will contract the regulated ratebase, further reducing the carriers' ability to cross-subsidize their nonregulated services improperly at the expense of the regulated ratepayers. As the area of competition widens, giving ratepayers and enhanced service competitors additional ways to satisfy their basic service needs, the carriers' ability to discriminate also will decrease. Such reliance on competition ultimately will achieve the objectives of universal telephone service and full use of modern telecommunications technology far more effectively than a regime of improper cross-subsidies and competitive exclusion designed to protect the domain of the regulated carriers.

In short, the larger the dominant carriers' regulated ratebase and the more complete their control over subscriber access, the greater is their ability to impair competition in nonregulated markets that depend on the regulated network, all at the expense of the ratepayer. The resulting impairment of competition means fewer product choices, less innovation, and higher prices for the end users of telecommunications services. Further consequences for the nation as a whole are reduced productivity and impaired ability to compete in international markets. The ultimate solution to these problems is the introduction of competition against the carriers' regulated services, wherever technology makes such competition feasible. The solution to the bottleneck problem is to eliminate the bottleneck.

Competition in basic services offers the promise of using technological advances to achieve lower costs and wider choice for end users of all telecommunications-related services. Unfortunately, as technology is making competition in basic services increasingly viable, competition is often prevented by artificial means—such as entry regulation and practices that give the carriers' regulated offerings an unwarranted price or access advantage over their incipient rivals. For example, the BOCs have typically opposed competition in intra-LATA toll service, although the technology is available to make this market as competitive as the interstate and inter-LATA long-distance marketplace. They have similarly opposed resale of local telephone service and shared telecommunications services ("STS"), arguing that state regulators should forbid office and condominium tenants from acquiring their own switches and concentrated trunk lines or should subject them to burdensome common carrier regulation. Similarly, most BOCs offer packet-switched data services under tariff and seek, in Phase II of the FCC's Computer III proceeding, to incorporate presently nonregulated protocol conversion services into the tariffed packet offerings. Yet both services are admittedly competitive and have been offered for years by independent, nonregulated data networks and database vendors.

One way to open basic service markets to competition would be to give state commissions the first opportunity to achieve these objectives, with the FCC authorized to act only where states fail to do so. Alternatively, the FCC could be encouraged to authorize competition in local basic services where feasible (as it has for interstate services) and to deregulate such services as they become effectively competitive. Whatever mechanism is used, the goal should be the same: The BOCs would be allowed to enter new competitive areas as the legal barriers are removed to competition in basic services.

We recognize that federal action with respect to local services inevitably raises issues of preemption of state regulatory authority. As we now discuss, we believe it is increasingly important to ensure that the FCC will have authority to implement federal telecommunications policies on a nationwide basis.

III. FCC AUTHORITY TO IMPLEMENT NATIONAL TELECOMMUNICATIONS POLICY

The BOCs can reasonably be asked to cooperate in opening up competition where it is feasible in basic services as a quid pro quo for entry into new nonregulated areas themselves, but the FCC's power to enforce such a result in the face of conflicting state regulation is subject to some uncertainty as a result of recent court rulings concerning the FCC's preemption authority. Congress should encourage the states, and give them the opportunity, to implement procompetitive policies. Congress also should clarify that the FCC has the authority, judiciously asserted by the FCC in the past, to preempt state telecommunications regulation when it finds that such regulation impairs the implementation of national telecommunications policy. This will assure that the removal of line-of-business restrictions on the BOCs can be accompanied by effective nonstructural safeguards and by the removal of artificial restrictions on competition in basic services.

IV. INTERNATIONAL TRADE

Increasingly, U.S. telecommunications policies affect not only international telecommunications to and from the United States but also the development of telecommunications policies in other countries with which Americans trade and in which they do business. All those involved in formulating U.S. policies in this area should be alert to the international trade implications of those policies.

Recent actions in the United Kingdom, Canada, Japan, the Netherlands, and elsewhere demonstrate a trend toward liberalization of national telecommunications policies. These steps presage a major movement among our trading partners away from traditional policies that were centered on state-owned monopolies (the "PTTs"). The PTTs have procured most of their equipment from designated domestic suppliers and have severely restricted non-PTT provision of customer premises equipment and enhanced services—leaving little trading opportunity for American suppliers. One factor that has encouraged this liberalization abroad is the success of the U.S. policies of deregulation and reliance on competition.

This favorable influence is undermined by recent proposals in Phase II of the FCC's Computer III proceeding potentially to reregulate protocol conversion, network channel termination equipment ("NCTE"), and customer premises multiplexers. Those proposals would have the effect of precluding participation by noncarrier supplies (domestic and foreign) in portions of the U.S. marketplace that are now freely competitive. Such backtracking would come at a bad time—just as our trading partners are considering further steps to liberalize their own telecommunications environments, and as the CCITT working group charged with developing standards for integrated services digital networks ("ISDNs") is considering to what extent those standards should accommodate multiple providers of equipment and services. Any congressional action in this area should encourage the FCC to reestablish its initiative and resume its procompetitive course.

International trade implications should be assessed also in connection with any removal of the line-of-business restrictions on the BOCs. If the BOCs are authorized to manufacture telecommunications equipment, consideration should be given to what safeguards are necessary to prevent a return to the relatively closed procurement practices that characterized the former Bell System. In bilateral talks with representatives of foreign governments, U.S. government representatives rely on the open nature of the American marketplace in advocating a reciprocal openness to U.S. suppliers abroad. Foreign governments cannot be expected to continue to open their equipment marketplaces to U.S. vendors if they perceive that the United States is reverting to a market structure that will as a practical matter preclude their companies from selling here.

ATTACHMENT A

IBM has commented in several FCC proceedings on the nonstructural safeguards that are necessary to protect ratepayers and competitors from the adverse effects of improper cross-subsidies and discrimination when dominant carriers participate in nonregulated businesses. IBM's key recommendations with respect to such safeguards are summarized below.

A. Accounting and Cost Allocation

In its recent Computer III Order, as in the AT&T Structural Relief Order, the FCC recognized that an accurate identification and full distribution of direct and common costs is the obvious first requirement when a regulated company is permitted to engage in unseparated nonregulated ventures. The dominant carrier has an incentive to favor its shareholders rather than its ratepayers (who are not in a position to "vote with their feet") in apportioning costs, investments, and any efficiency benefits achievable through integration or sharing, thereby giving its nonregulated venture an unfair competitive edge in the marketplace at the ratepayers' expense and reducing the shareholders' risks in competitive lines of business.

The FCC does not yet have regulations in place to specify the cost allocation and accounting principles and procedures that will apply when dominant carriers engage in nonregulated businesses on an unseparated basis. The formulation of such regulations is the objective of the FCC's pending Joint Costs Proceeding, in which IBM has submitted recommendations. Any legislation in this area must be somewhat general, allowing the FCC to define the requirements in more detail. However, a few basic principles should guide the FCC in its work, as described below.

Carriers should be required to maximize direct assignment of costs that benefit one activity or the other to the subsidiary ledgers for the regulated and nonregulated operations. Before a dominant carrier is permitted to share resources between its regulated and nonregulated activities, the carrier should be required to have in place an approved cost allocation and accounting plan that distributes the costs and risks of all the resources associated with the two classes of activities in an objective and auditable fashion. The cost allocation and accounting system must identify and distribute all of the recorded costs incurred to benefit each of the two sectors. Some of the BOCs advocate a form of incremental costing rather than the fully distributed costing ("FDC") that the FCC has long required to separate regulated and nonregulated costs. Others accept the FDC is the proper approach in general but ask for exceptions when a service offered with ratebase facilities is later deregulated or when assets justified initially for the ratebase are later shared to produce revenues in nonregulated businesses as well. Such exceptions should not be permitted.

The FCC should continue to require FDC methods, preferably those relying on historical rather than projected costs (which are more difficult to audit and to reconcile with actual incurred costs). To allow incremental costing would be to assume that the ratepayers "would have incurred the expense anyway" and that new applications for old assets are essentially "free." However, it is far more appropriate to treat each service for which a resource is used as having caused the cost of that resouce in proportion to its share of the use. That approach is necessary to avoid giving carriers an incentive over time to seek to justify imposing on ratepayers the initial and predominant cost of all shared resouces. There is no legitimate rationale for giving the shareholders the advantage of any efficiency benefits gained by sharing resources while denying a proportionate share of those benefits to the ratepayers. The nonregulated business activity should bear a proportionate share of all of the costs that benefit it.

Nonregulated activities also should bear a proportionate share of the investment risk associated with shared depreciable assets. Accordingly, a portion of investments planned for both regulated and nonregulated use should be booked from the beginning to the nonregulated accounts rather than the ratebase. In similar fashion, if an asset initially used only in regulated operations is later shared with a nonregulated venture, a portion of the remaining book value of the asset should at that time be transferred to the nonregulated accounts, based on its intended use. Thereafter, a part of the risk of loss or failure will pass to the shareholders rather than the ratepayers. This will assure equity for the ratepayers, and it also will prevent the dominant carriers from entering nonregulated markets with an unwarranted competitive advantage that would deter other potential entrants.

The cost allocation and accounting guidelines should discourage reliance on subjective time-reporting judgments by numerous employees. Marketing personnel, for example, should be designated as regulated or nonregulated according to their areas of expertise, with exception time reporting for time devoted to activities in the other sector. As a result, the costs and risks associated with personnel, like those associated with other resources, would be properly distributed. That approach would be more reliable and auditable than an attempt to audit a sample of positive time reporting that is likely to be biased and nearly impossible to verify.

B. Transmission at tariff

The FCC has wisely insisted that carriers unbundle their basic service elements and make them available under tariff to their nonregulated businesses as well as to resellers and to rival providers of enhanced services. The "building block" and "taking at tariff" principles embodied in this requirement should continue to guide the FCC in protecting against improper cross-subsidies and discrimination. Where a carrier offers a service under a cost-justified tariff, the tariff establishes the appropriate measure of the FDC cost of the service; any attempt by the carrier to charge its nonregulated business less than that is an impermissible (and discriminatory) form of incremental costing. Unbundling and reliance on underlying tariff rates provides a ready means of assuring equal treatment for rival service providers who depend on the same network servicers in offering their own services.

C. Comparably efficient interconnection and open network architecture

A critical feature of any plan allowing dominant carriers to integrate regulated and nonregulated operations is an effective means of ensuring nondiscriminatory access to basic telecommunications network services. The FCC took significant steps to ensure such access in its recent Computer III Order, requiring carriers to furnish "comparably efficient interconnection" ("CEI") and, in the next few years, to develop plans for an "open network architecture" ("ONA") that will give all service providers, including the carriers themselves, the same efficient access to the regulated network, at the same prices. As long as parts of the public network remain regulated, all providers of competitive services that depend on the use of that network will need comparably efficient access to its facilities; and the carriers must not be allowed to design their facilities in a discriminatory manner so as to favor their own nonregulated businesses and foreclose efficient competitive access to the regulated network. CEI and ONA are evolving concepts, but it is important that any legislative mandate concerning the dominant carriers' entry into nonregulated businesses include a confirmation of the CEI/ONA principle of comparable access.

D. Network information

The FCC has made substantial progress in crafting rules to ensure that the carriers make timely disclosure of network information that is necessary to enable competitors and users to accommodate changes in network design. Carriers must disclose information concerning public network facilities and the specifications of the network interface as soon as the design becomes stable (at the point of the "make or buy" decision for products the design of which affects or relies on the network interface). This gives equipment manufacturers, resellers, rival providers of enhanced services, and users an opportunity to accommodate network changes. Otherwise, the dominant carriers, with advance information about network changes, could preempt competitive markets for equipment and services. For this reason, a network information disclosure requirement is a critical safeguard as dominant carriers enter nonregulated businesses.

E. Procedures for nondiscriminatory service

Competition in telecommunications services and equipment will not be meaningful if customers perceive that those who order competitive equipment or services from the carrier will get faster or better installation and maintenance of their regulated network services. The FCC's recent Computer III Order protects against such abuse by requiring the carriers to implement central operations groups ("COGs") or similar procedures to ensure equitable processing of service and maintenance requests. Such a requirement remains essential to prevent discrimination.

F. Auditing

The FCC's financial auditing rules for mixed regulated/nonregulated businesses will be developed in the pending Joint Costs Proceeding. The likely and appropriate result is a combination of FCC review and an annual independent "attest" audit affirming (a) that the carrier's cost allocation and accounting plans conform to FCC guidelines and (b) that the carrier's practices comport with the approved plans. Such audit and review requirements are clearly essential to ensure that the cost allocation and accounting safeguard will not be a mere paper tiger.

The FCC should adopt similar audit requirements for other nonstructural safeguards as well. Each of the nonstructural safeguards will involve first the design and then the implementation of detailed plans and procedures to comply with principles established by the FCC. An attest audit by an independent accounting firm will be an invaluable means for the FCC to ensure that ratepayers and users of competitive services receive the protection the safeguards are intended to give them.

STATEMENT OF THE INTERNATIONAL COMMUNICATIONS ASSOCIATION

INTRODUCTION

The International Communications Association (ICA) greatly appreciates the opportunity to submit its written testimony on S. 2565, the Danforth amendment proposals, and related issues. ICA is the largest and broadest-based association of business telecommunications users in the United States. While ICA had hoped to have the opportunity to participate in the two half-day's hearings, this opportunity to provide the Committee with ICA's written testimony is an excellent interim solution to the problem of considering the views of all interested parties until additional hearings can be scheduled by the Committee.

ICA is a not-for-profit business league of major corporate, educational, and governmental users of telecommunications equipment, facilities, and services whose over 600 members each spend at least $1 million per year on telecommunications. The bulk of these expenditures occur within the United States, but many ICA members make substantial expenditures for telecommunications services in other countries. Collectively, ICA members spend over $15 billion per year on telecommunications expenditures. As telecommunications users, ICA members are interested in promoting the broadest possible competition in telecommunications and information services. Also, ICA expects that the prices for these services and telecommunications equipment and facilities will be cost-based. The entry by the user community's dominant suppliers of local telephone services, the Bell operating companies, however, must be accomplished in a manner that does not damage the growth of competition that has occurred within the industry in recent years. ICA members' need to plan their utilization of telecommunications resources, forecast costs, prepare budgets and implement new technology according to recognized financial and engineering criteria. Therefore, any deliberations that propose changes in existing telecommunications policies should take into consideration the impact such changes might have on large users.

ICA opposes S. 2565 as introduced, because it does not balance these critical requirements for a stable telecommunications industry with the desires of the BOCs to enter into currently prohibited lines of business. The legislation would place significantly greater emphasis on the Federal Communications Commission's ("FCC") capabilities, but ICA is far from certain that the FCC has an adequate level of staffing, expertise, and computing power to properly handle its current authority. The legislation would be capable of properly bearing this role.

As ICA discusses in response to Senator Danforth's questions, below, the Commission is now exploring regulatory tools and deregulation issues which, if implemented successfully and coupled with appropriate FCC staff resources and analytical methods, might provide an appropriate substitute for enforcement of the terms of the AT&T divestiture. S. 2565 provides no tools or guidelines to help this possibility to become reality. If Congress is to consider legislation such as S. 2565, it has an obligation to ensure that the FCC completes the implementation of these new policies, demonstrates that they are effective, and avoids *ad hoc* processes, such as waivers, for continued enforcement of these mechanisms. In evaluating telecommunications policy issues, Congress should base its judgments on facts, rather than mere rhetoric, to the fullest extent possible. Responsible ratepayer protection amendments to S. 2565 would be necessary to ensure that the FCC fulfills these requirements, if Congress decides to address the concerns of the BOCs[1] legislatively.

Answers to specific Senator Danforth questions

II. PETITIONS FOR WAIVER, MODIFICATION OR ELIMINATION OF CURRENT RESTRICTIONS

II. B. Competitive entry.

Question. What is the appropriate time limitation for FCC action on a pending petition?

Answer. Congress should not legislate a specific time limitation with respect to any BOC competitive entry petition. The time needed to evaluate each petition, or a common set of petitions filed by several BOCs, depends on several factors that cannot be adequately determined in advance. Different requests likely will raise factual questions of different complexity. The time required for FCC action depends upon the degree of this complexity and upon the adequacy of the data submitted by the BOC in support of any such petition.

The BOCs should not have incentives to withhold data necessary for the FCC to evaluate any petitions. The FCC's initial access charge tariffs were scheduled to become effective January 1, 1984, but were delayed from five to 16 months largely on account of errors and omissions in the BOCs' and other local carriers data. Access charges, unlike the matters raised with respect to BOC entry into new businesses, involved services and facilities that had existed for some time and were covered by substantial records. A number of the factual questions that the FCC might be called upon to answer with respect to competitive entry could be delayed as long as were the access charge tariffs, with proper data is not submitted with BOC entry requests.

Each FCC investigation must permit interested parties sufficient time to evaluate the requests and prepare specific responses. Public comments must be permitted in advance of FCC action on such a petition, and the FCC should note how it has accounted for such public comments with specificity in any order on these petitions. ICA views the FCC's recent action in permitting an AT&T accounting plan to go into effect *prior to any opportunity for public comment* (FCC Docket 85-26) as an example of highly misguided decision making and a poor precedent for future FCC determinations. Finally, in granting a BOC petition, the FCC should also be required to determine that the *costs* as well as "the economic risks associated with the competitive business would not be borne by local ratepayers." The term "economic risks" might suggest that only the lack of BOC profitability in the new business, not the cost to local ratepayers, need be considered by the FCC. To ensure affordable telephone service, both the economic risks and the costs of a BOC entering into new business should not be borne by local ratepayers.

II. C. Public interest factors.

Question. What are the relevant markets and submarkets for determining the potential effect on competition; e.g., should the domestic or world market be considered? What are the relevant goods and services markets?

Answer. Any large geographic market test is likely to be inadequate with respect to BOCs, whose market power is concentrated in "the last mile" of the telephone network, and who have market shares in excess of 95% in most major metropolitan areas of the continental U.S. Product market tests may prove more useful, because each market that the BOCs wish to enter—particularly information products and services markets—currently are populated by various numbers of vendors. The products of these vendors should be classified, in part, by the proportion or percentage that, indeed, dependent on the BOCs "last mile" telephone network. This analysis would address the BOCs ability to leverage their market entry efforts through pricing and service changes in regulated services.

Question. How much time should agencies have to provide their (i.e., government agencies) determinations to the FCC?

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[1] Hereafter the term Bell operating companies ("BOCs") is intended to include the regional holding companies for these carriers.

Answer. ICA's response to Question *II. B.*, above, should apply to any commenter, public and inter-agency alike, in FCC investigations.

Question. Should a distinction be drawn between entry into a competitive market through acquisition versus independent entry? How should the FCC analyze the costs and benefits of regulation?

Answer. No. Acquisition through entry may give the BOCs larger initial market shares and thus implicate certain competitive concerns that would not arise in an independent, start-up entry situation. The start-up entry, however, is likely to be perceived by the BOC as being more risky, and thus incentives to cross-subsidize, or otherwise leverage, this type of entry may be greater than in an acquisition situation. ICA is unable to find a basis for differentiating the two situations in advance of a factual setting.

The legislation should promote a simple cost/benefit standard: local ratepayers of basic services should not have to pay any cost related to a BOC's entry into a new business. The determination of benefits to local ratepayers, if any other standard were used, would be impossible to quantify, open to controversy, and difficult for Congress to oversee. The only practical way is to prohibit a BOC from changing local ratepayers for any of the costs of new business, regardless of benefits claimed for those ratepayers.

III. FCC REGULATIONS

III. A1. Accounting and cost allocation.

Question. Are the FCC's current regulations an effective check? Do the state regulatory agencies have sufficient effect?

Answer. The FCC has yet to complete its cost accounting and allocation proceeding. Once it does, some initial judgments can be made as to the effectiveness of those rules.

Several important concerns now exist as to how well the FCC is carrying out its current regulatory duties which, in turn, bear on what Congressional safeguards are necessary if the FCC were given the added authority to administer the Modified Final Judgment (MFJ).

The first concern involves the Commission treatment of BOC increases in many business private line rates over the last 18 months. Most recently, many BOCs filed for "mid-course corrections" in their special access rates and the FCC, on very short notice, permitted them to become effective. These latest increases cover 17 states and the District of Columbia and averaged in the range of 20-25%. Unfortunately, the FCC in granting its approval failed to follow traditional rate regulation practices, and as a result, these special access rate increases were not adequately justified by the BOCs. The FCC's failure to follow past practices has left BOC customers unprotected against frequent rate increases. Their only remedy would be the costly, time-consuming FCC tariff complaint process. This failure of the FCC to adequately handle its present regulatory duties raises serious concern with regard to the BOCs entering new businesses. Unless the current FCC tariff review process is effective, local ratepayers could be subsidizing the new BOC competitive ventures through the overpayment for BOC monopoly services.

The FCC Computer III concepts of "comparable efficient interconnection" and "open network architecture" are predicated on the BOCs paying tariffed rates for the local services they would utilize in providing information services; in theory BOC competitors would take comparable facilities under the same tariffs. However, tariff pricing can be used to manipulate the BOCs' versus competitors' costs. The probability of this occurring is raised by current BOC claims, seeking reconsideration of the Computer III Order, that their "own" tariff for CEI will be different than the one applied to other vendors or that they are concerned about "tariff shopping." The latter term means that CEI tariffs may be priced higher or lower than existing tariffs covering the same basic network facilities or services. Clearly, the adequacy of the FCC's tariff review process is a critical concern in addressing what safeguards are needed before the BOC's are allowed to enter any new business.

As ICA notes in its response to Question IV. D, below, the states' expertise in these areas must be weighed against the confusion and multiple policies that would exist if state authorities were able to substitute their policy judgments for those of the federal government. It makes no sense for tariff review authority to be bifurcated between the states and the FCC, as has occurred with respect to packet switching services and asynchonous/X.25 protocol conversion services, if the FCC lacks the expertise or will to oversee state tariff determinations. Some states have allowed BOCs to tariff low-cost digital transport offerings that are not available at equivalent, low prices in FCC-regulated tariffs. This could lead to potential discriminations against interstate, interLATA services.

The second concern is with the Commission's implementation of its current Computer III Inquiry decision. While under its Computer II rules the BOCs are required to set up separate subsidiaries from which to engage in unregulated business, the Commission has never publicly audited their performance. A recent study by the California Public Utilities Commission staff has identified a number of troubling transfers from Pacific Bell's regulated local monopoly business to its new unregulated businesses. The California PUC study found that Pacific Bell failed to fairly compensate the monopoly business for these transfers resulting in local ratepayers being partially burdened by Pacific Telesis' new business ventures. The state audits raise a serious question as to whether the FCC is doing an adequate job even under its current rules to protect ratepayers. As a result, many now question whether the FCC is capable of carrying out the additional responsibilities of administering the MFJ.

Question. What requirements should be set forth in legislation?

Answer. Legislation should include prompt court review of FCC decisions which permit tariff changes to go into effect. As mentioned above, ratepayers cannot challenge the FCC in court on a decision on petitions to suspend or reject a BOC tariff no matter how well-founded they might be. A ratepayer must file a formal complaint against the tariff with the FCC after it becomes effective, wait for FCC action on the complaint which has often occurred one or more years later, and then likely receive the same negative FCC response as in the case of the initial ratepayer petition. In some cases, court action itself, has had to be brought to compel the FCC to even act on the complaint. Then, only after FCC denial of the complaint can a ratepayer seek court review. Prompt court review of FCC action (or inaction) on petitions to suspend or reject tariff filings would be one major step to insuring that ratepayers are being charged rates that are "just and reasonable" and they are not being burdened by BOC entry into new businesses.

III. A2. Auditing.

Question. What protection is afforded by state regulation? Should the FCC be permitted to accept certification of outside public accountants in lieu of conducting its own audits?

Answer. As noted above, the FCC has yet to develop its cost accounting mechanism so that no party is able to comment definitively on it. ICA believes that the mechanism will not be successful unless it incorporates several critical features: (1) Market valuation of the assets, or shares of assets, transferred to or utilized by the BOCs competitive operations; this involves utilizing both current market values instead of historical book values for assets, identifying the market values of non-asset transfers, such as those identified in the California PUC audit, and use of a fully compensatory return on competitive assets, to the benefit of ratepayers. An arbitrary factor, such as 5%, cannot reflect these standards. (2) Use of largely identical, highly comparable, cost allocation and accounting standards for similar carriers, such as the BOCs. The BOCs "cost manuals" vary so greatly in scope, detail, and the degree of subjective cost allocations permitted therein, that, unless the FCC makes a major effort to base the cost accounting system upon defined, fixed input and output requirements, the system is unlikely to be effective. (3) Outside auditing by firms that have no appearance of a possible conflict of interest with the BOCs, as that term is understood to apply with respect to legal and other fiduciary relationships. The independent auditor's fiduciary duty should be to the public interest, not to the BOCs, and audits should produce standardized output reports that will be fully available for public review, and for comparison among the BOCs.

Question. Should the FCC be granted further authority to impose cost-of-regulation fees on the competitive affiliates of telephone companies to recover the direct costs incurred by the FCC in conducting audits? If the FCC is permitted to assess auditing fees, how should those fees be calculated?

Answer. The cost of auditing BOC compliance should be borne by the new BOC business venture and not the ratepayer. In keeping with the objective of protecting local ratepayers, *all* preliminary and ongoing regulatory costs of BOCs entering new businesses, such as audits, should be paid by BOC shareholders.

III. A3. Transfers of assets.

Question. (no question presented)

Answer. A serious question exists, as a result of state audits (see *III. A1.*, below) whether under current *Computer II* rules the BOCs are not already receiving unwarranted benefits from their regulated monopolies in furtherance of their new competitive business ventures. The FCC should be directed to require that all BOC transfers to their new businesses be at net book or fair market value, whichever is greater. This is another necessary safeguard to insuring that the local ratepayers do not pay for BOC entry into new businesses.

III. A4. Network information.

Question. Would existing regulations, such as those currently imposed by the FCC regarding the disclosure of network information, be adequate if telephone companies were permitted to enter new, competitive lines of business?

Answer. The utility of existing FCC network disclosure requirements depends on four factors that are not yet settled. *First*, the FCC must determine whether, in fact, it will continue to apply early disclosure ("make/buy") disclosure to the BOCs. *Second*, the form and efficacy of network information disclosure should continue to be subject to complaint procedures. If, for example, a system that a carrier already has reduced to a single micro-chip is disclosed by means of a 5000-page computer printout, the time required for disclosure of critical basic network information may not be sufficient. *Third*, although ICA recognizes the BOCs' right to protect their network network information, (parallel to users' rights to protect basic network information, discussed in *III. A5.*, below), guidelines and actual experience are required with respect to the types of protective agreements utilized by the BOCs for their transfers of network information. Guidelines and experience will demonstrate whether these protective agreements between carriers and their competitors who must utilize basic network facilities are working. *Fourth*, in some cases, the functions and technical features of "network" components remain undefined. Accordingly, before one can determine whether the "network information" disclosure is effective in preventing discrimination, exactly what defines the "network" must be established. For example, neither the FCC, nor industry standards-setting processes, have precisely defined the functionality of "network channel terminating equipment" (NCTE) with sufficient particularly to establish the technical features on the "network" side of such devices, and the functions residing in the devices themselves. While the definition may change with future network services and future types of terminating equipment, it is apparent that the "network information" disclosure rules can only be effective if the "network" functionality, as it exists today, is well-defined and understood throughout the industry.

Question. Without FCC regulation, how effective would anti-trust laws and FTC authority be to prevent unfair competition?

Answer. ICA believes that enforcement of the anti-trust laws normally takes too long from the standpoint of users of telecommunications and information services. Users must make economic selections within the bounds of annual budgeting and planning cycles; anti-trust actions take years to prosecute.

Additionally, many information services are supplied by enterprenurial, high technology start-up firms. It seems unlikely that these firms would have access to venture capital markets if they faced the added risk that anti-competitive actions against them could be resolved only through the anti-trust enforcement process.

III. A5. Customer information.

Question. Would existing FCC regulations be adequate if the telephone companies were permitted to enter competitive lines of business?

Answer. ICA views the protection and dissemination of customer proprietary network information as a critical issue with respect to the transfer of such information to the competitive operations of the BOCs and other carriers. ICA supports requiring carriers to obtain affirmative permission from individual customers prior to the carrier's effecting a transfer or dissemination of the customer network information to the carrier's competitive operations or to any other entity. ICA opposes carrier proposals before the FCC to implement protection of customer information only by means of a "negative veto," prohibiting the information transfer only if the customer objects within a specified time. Substantial experience with industry changes since the AT&T divestiture conclusively demonstrates that "negative veto" procedures place undue burdens on users to understand, interpret and act to protect their proprietary information.

However, in recognition of carrier concerns that the affirmative disclosure process would place burdens on the carriers, and recognizing that the sensitive nature of telecommunications information is substantially greater for business customers, ICA has proposed to the FCC that the affirmative disclosure be limited to multi-line business customers, who are separately identified in the carriers' records.

Every user group that has commented on this issue before the FCC has opposed the "negative veto" procedures. These users include firms that operate sensitive data communications networks, critical supervisory systems and control facilities. The federal executive agencies and the Department of Defense take the same position. There is no basis for granting personnel—who do not have a "need to know"—unfettered access to sensitive network data, whether the data implicates national security concerns or discloses private corporations' business operations, competitive plans and network systems.

As is the case with other policies addressed in these questions, the FCC has yet to define a set of rules for the dissemination of basic network data to the carrier's marketing and planning personnel for competitive services. Accordingly, ICA cannot address the efficacy of the FCC policies at this time.

III. A.7 Financing.

Question. Should the FCC require competitive affiliates to obtain their own debt (or other) financing on their own credit? Should S. 2565 be amended to prohibit any entity affiliated with a petitioning telephone company to guarantee the debt associated with a competitive venture in a manner that would permit a creditor, on default, to have recourse to the assets of the local telephone company?

Answer. In its November, 1985 initial comments in the FCC Computer III proceeding, ICA noted that the series of "non-structural safeguards" might well include outside capitalization requirements for BOC competitive operations. The FCC has since proposed to reduce existing requirements for review of the capitalization of new competitive ventures. Two problems exist with outside capitalization requirements. First, although the FCC has stated that it will end Computer II's fully separated subsidiary requirements, it has not specified whether a corporate entity which is different from the BOC telephone utility operation will be established for enhanced information services. Thus, it is not clear whether the information service entity would have a distinct capital structure, by which outside financing requirements could be measured. Second, outside debt financing has no efficacy as a marketplace check if the BOCs are permitted to elect 100% equity financing. The MFJ Court's procedures for line of business waivers established a requirement that the BOCs should utilize outside debt financing, if they utilized debt financing at all. No BOC has utilized outside debt financing at this time, to ICA's knowledge. Accordingly, BOC equity, the more expensive securities, bear the entire added risk of entry into competitive ventures.

ICA continues to believe that it is appropriate to specify that the corporate affiliate be separately capitalized, even if it is not a fully separate subsidiary, and that both a minimum level of debt financing (such as 10%) and outside generation of such debt capital would provide a useful marketplace check on the soundness of BOC competitive ventures.

III. A8. Separate subsidiaries.

Question. Should structural separations be required for certain lines of business? Are there cases in which non-structural safeguards would be inadequate to prevent cross-subsidization of a competitive venture or anticompetitive behavior? For example, should the entry of telephone companies into the manufacture of telecommunications equipment and provision of long distance services be conditioned on a requirement of separate subsidiaries?

Answer. Separate subsidiaries may well be appropriate for critical lines of business. Today, for example, interLATA communications are handled by entities that are completely separate firms from the BOCs, not merely subsidiaries under common ownership. ICA is unware of any analysis demonstrating that the American economy experiences any long-term losses of economic efficiency because of the current structure for provisioning of interLATA communications. Post-divestiture confusion and disruption definitely occurred, but that is not, itself, evidence that real economic efficiencies are being sacrificed. Most competitors are suffering little or no earnings in competition with AT&T Communications in interLATA markets and price margins between the suppliers are narrowing substantially. ICA is aware of no economic analysis even suggesting that re-entry of the BOCs in this market would substantially alter either the cost or structural conditions for interLATA service, or significantly change the concentration of this market—unless the BOCs lowered the operating costs of an interLATA network via cross subsidization at the expense of their existing local service ratepayers or created disincentives for local ratepayer use of non-BOC supplied interLATA services.

The same conditions appear to apply to manufacturing of telecommunications equipment. Currently, strong price competition in most end user equipment products has reduced vendor margins significantly; the same appears to be true with respect to suppliers marketing large switches to telecommunications carriers. One outcome of existing price competition has been a reduction in American employment, as manufacturers such as AT&T/Western Electric shut down large domestic manufacturing facilities and transferred some production overseas. This change accounts for a significant part of the decrease in the telecommunications trade balance. Congress should assure itself that BOC entry into manufacturing would not simply replicate the same process of exporting employment. It may appear that the BOCs could exempt themselves from existing market forces in telecommunications equipment only by cross-subsidization of such operations by regulated network services. Separate subsidiaries could prevent such an occurrence, and would not disadvantage ratepayers in any way, because BOC representatives testified with respect to HR 3800 that they would not flow back any profits to ratepayers of basic services.

As noted, the effectiveness of the FCC's non-structural safeguards is uncertain at this time. There is even serious question about the effectiveness of the separate subsidiary requirement under current *Computer II* rules. There are, however, several options that can be considered in response to the question. One approach would be to require separate subsidiaries *and* basic safeguards to protect local ratepayers for all new businesses. A second, more flexible approach would give the FCC the option of not requiring separate subsidiaries based upon a showing that non-structural safeguards were adequate to protect local ratepayers,

III. 3B. Separate subsidiary.

Question. Should separate subsidiaries be required for the manufacturing of telecommunications equipment?

Answer. Refer to response to Question III. A8, above.

III. D1. Long distance separate subsidiaries.

Question. Should separate subsidiaries be required for the provision of long distance carriers?

Answer. Refer to response to Question III. A8, above.

III. D2. Other conditions.

Question. Should a distinction be made between leasing versus ownership of long distance facilities?

Answer. No.

IV. D. State regulatory jurisdiction.

Question. What should the role of the state regulatory bodies be with regard to the lifting of existing line of business restrictions?

Question. Should a Federal-State Joint Board be convened to set forth accounting or other standards to protect ratepayers and safeguard competition?

Answer. (Answer is in response to both *IV. D.* questions.) ICA believes that state regulatory authorities have substantial expertise in the areas that would be required to control and administer BOC entry into additional competitive lines of business. The number of state-level staff personnel experienced in accounting, auditing, tariff administration and the examination of the BOCs' telephone utility operations substantially exceeds the staffing, experience, and computing tools of the FCC's Common Carrier Bureau. As noted in *III. A1.*, above, the California Public Utility Commission staff has conducted a far more extensive audit investigation of transfers between Pacific Bell and other Pacific Telesis operations than the FCC has been able to mount with respect to any of the BOCs' separate subsidiaries. The investigation concluded that abuses existed, the type and detail of which could not have been uncovered by FCC staff personnel or outside accounting and auditing personnel who lacked experience in the telephone industry.

Nevertheless, state-level activity also carries the risk of multiple, inconsistent geographical treatments of basic services and the carriers' competitive operations. ICA has stated to the FCC its fear that the ruling in *Louisiana Public Service Commission versus FCC* [2] and differing state treatments of the separation of basic and competitive services risks disruptions that would impair the multi-state telecommunications networks of many ICA members.

STATEMENT OF THE JOINT COOPERATIVE COMMUNICATIONS ASSOCIATION

SUMMARY

The JCCA, a cross-section of rural agribusiness cooperatives, is concerned about preserving and improving the quality, variety and affordabilty of telecommunications services offered throughout rural America. The JCCA sees the potential elimination of certain decree line of business and other restrictions on the BOCs and

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[2] U.S. Supreme Court, number 84-871 *et al.*, —US—, US Law Week, May 27, 1986.

GTOCs contributing both positively and negatively toward satisfying and disrupting these concerns. However, the JCCA is not convinced that the Federal Communications Commission, acting alone, is best qualified to judge whether, when and under what conditions removal of the decree restrictions should take place.

The JCCA submits that the telecommunications needs of some categories of end users and of some regions of the country can only be adequately looked after by regulatory authorities much closer to their constituents. Specifically, the JCCA believes that it is imperative that state regulatory agencies play a major role in determining the timing and conditions under which the decrees' restrictions ought to be relaxed, if at all, as to any Regional Holding Company, BOC, or GTOC.

To be effective, however, the role of the states needs to be much different than any role they have played in the past. The JCCA proposes that the FCC should be required to deal with the states on major matters concerning decree restrictions—not on a state-by-state basis, however, but on a regional basis where the regions are defined by the seven RHC geographic serving areas. The JCCA recommends that this involvement should take the form of regional Joint Boards fashioned after the existing Section 410(a) Joint Board provision in the existing statute.

INTRODUCTION

The Joint Cooperative Communications Association (JCCA) is a soon to be incorporated not-for-profit association of agribusiness cooperatives. It is comprised of seven member companies serving approximately 1 million member farmers, ranchers and users of agricultural-related products.

The JCCA members, as well as their individual constituents, are generally located in rural farm and ranch land areas of the 50 states. The are accustomed, unfortunately, to sometimes receiving inferior telephone service from small independent companies; being served a limited menu of special voice and data services even by the largest carriers such as AT&T and the BOCs; and being among the last to receive low cost competitive long distance services. While affordable and universal service, and averaged long distance rates are still a reality in rural areas today, the JCCA is not so confident that these basic characteristics of the world's finest telecommunications system will remain forever, particularly if further deregulatory actions, including removal of decree restrictions, continue to be made only at the federal level. Moreover, and equally important, as businesses struggling to survive in the most economically depressed areas of this country—the farm and ranch lands of virtually every agricultural of dairy state—JCCA members and their farmer and rancher constituents need the benefit of the full panoply of low cost telecommunications, high speed data services, and enhanced offerings to improve the efficiency of their operations.

The JCCA is not confident that the FCC, acting alone, is capable of guaranteeing that these needs of rural America will be met.[1] Instead, the JCCA feels that the states, not acting alone and independently as many are currently doing, but acting in concert with the FCC and on a regional basis, offer the best assurance that the interests of their rural constituents will be protected.

THE ROLE OF THE STATES

Senator Danforth's proposed amendments to S. 2565 invited comment on the role of the state regulatory bodies with regard to lifting the decree's line of business restrictions.

The debate no longer appears to be over whether the states should have a role, but over what it should be.[2]

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[1] The JCCA is aware, however, of recent public statements by FCC Chairman Mark Fowler assuring that the needs of Rural America will be protected. The JCCA encourages the Chairman to live up to these commitments.

[2] Apparently this perception exists even within the FCC as evidenced by the following remark in an address by William A. Russell, Jr., former Director, Office of Congressional and Public Affairs, Federal Communications Commission before the National Conference of State Legislature's 12th Annual Meeting:

"Finally, there has been some controversy over adding language to the Dole Bill clarifying the role of the states in telecommunications regulation. There is a practical political need to discourage amendments to a very complex bill. The more you give them the more special interests want until a bill may sink of its own weight. However, I think that some accommodation to state concerns is possible while still keeping the bill clean. States are not just another special interest group. Under a federal system of government legitimate state interests must be taken into account." From a presentation entitled "Don't Hang Up! A Perspective on Telephone Industry Legislation At the State and Federal Level," August 5, 1986, New Orleans, LA.

As the recent Supreme Court decision in *Louisiana Public Service Commission* v. *FCC*, No. 84-871 (May 27, 1986) has proven, the states often do have a reasonable perspective on matters that others may see as only a federal issue. The JCCA submits that the collective wisdom of the states will prove to be beneficial in untangling the BOCs and GTOCs from the bondage of their respective decrees. However, the JCCA does not believe that, in the area of major new business opportunities for the BOCs and their parent Regional Holding Companies, the issues lend themselves to state-by-state determination. A decision by the State of Washington, for example, prohibiting Pacific Northwest Bell from entering into a manufacturing enterprise does little to protect the welfare of Washington ratepayers if PNB simply decides to locate its new business in Oregon. The states, individually, would be similarly powerless to effectuate basic safeguards around the BOCs entry into deregulated fields. In the present environment state imposed separate subsidiary requirements will simply drive the RHC to locate its enterprise elsewhere in its region, and stiff accounting demands in one state will only invite the shifting of costs and/or revenues among the RHC's BOC enterprises between states within its region.

On the other hand, it would prove equally awkward and a great handicap to the RHCs if the states' role in the line of business waiver process were such that they alone could, on a state-by-state basis, permit or deny RHC entry into new business ventures. Obviously, if the RHC is to be permitted to enter new businesses, it should be permitted to do so under consistent terms throughout its geographic local exchange service market areas. However, this level of consistency can be achieved by means other than by placing the total decision making responsibility solely in the hands of the FCC.

This is the level at which the states ought to play a role—at the regional level. When it comes to deciding whether, when and under what system of safeguards the RHCs, BOCs or GTOCs should be permitted to enter new lines of business, the states most directly affected should have a substantial say-so in establishing the terms. In the JCCA's view, the major line of business issues such as manufacturing, interLATA long distance, and any other restricted venture likely to consume a substantial proportion of an RHC's or GTOCs resources should be dealt with in the future on a regional basis, with the FCC administering the process but deferring to the will of the state regulators represented by the consensus of the states making up the region served by the RHC or GTOCs.

The Seven Regions as Natural Areas of Common State Interests

One of the greatly underappreciated legacies of divestiture is the brilliant system of LATAs and the division of the states into seven regional operating territories served by the seven RHCs. Not only have these divisions proved to be logical and sound for the MFJ's divestiture and the resulting RHC's corporate business purposes, but they also have the potential of serving other political and economic interests as well. For example, both MCI and U.S. Sprint have structured corporate divisions around the seven regional territories, and countless telecommunications vendors, for sure, are probably also similarly structured to conduct their businesses on the basis of the RHC regions. Whether by coincidence or masterful planning, the seven RHC service areas seem to have succeeded in defining seven geographical regions of the country with very similar communities of interest.

The JCCA recognizes a strong community of interest within the regions among its members and it would like to see a system of telecommunications policy making and regulation take these newly established spheres of regional activity into consideration. Even within the JCCA the telecommunications needs and priorities of its members situated throughout the NYNEX region, for example, are quite different than those of its members distributed throughout the vast rural areas of the U.S. West region. It would be an affordable, manageable and potentially more effective task for the JCCA and other interests like it to monitor and deal with line of business waiver issues on a regional rather than national basis. The prospects of NYNEX or Ameritech entering the manufacturing business need not be of major concern to or involve the JCCA's rural interests; but the likelihood that U.S. West's entry into interLATA competition could be delayed because the FCC might perceive a glut of excess capacity in the east and southern regions would be of concern.

As the experience with the gradual transition from state to regional banking is demonstrating, large scale competitive and economic issues need not be resolved from only an intrastate or interstate perspective. We now have a regional system of telecommunications in place which is both sound and administratively practical, and it ought to be recognized for regulatory purposes.

The Legislative Vehicle for Implementing a Regional State Role

There has existed in the Communications Act for years so-called Joint Board statutory provisions whereby the FCC has been authorized to engage representatives of the state regulatory agencies to assist in resolving particular questions of overlapping state and federal interest. (47 U.S.C. Sec. 410(a), (b) and (c).) Federal-State Joint Boards have resolved, for example, the question of CPE registration and direct connection, and have been active almost continuously in resolving issues of cost allocation arising out of the FCC's scheme of access rules and regulations.

The JCCA submits that this vehicle is a natural for extending to the states a role in the transfer of the decrees' line of business waiver responsibilities—with only a few changes required.

Joint Boards are currently comprised of up to only four state representatives without regard to the part of the country they may represent. Instead, a Section 410(a) and (c) type Joint Board procedure ought to be established which would require that selective waiver requests involving such ventures as interLATA service, manufacturing and enhanced or information services be entertained only on a regional basis. The FCC should be required to convene panels of state commissioners representing each state potentially affected by the line-of-business waiver being sought. Such pannels would be chaired by an FCC Commissioner and administered by the agency. The recommendations of the panel, derived following conventional administrative notice and comment procedures, would thereafter either be adopted by the full Commission as presented, or vetoed in favor of the *status quo*. Such a process would ensure that the views of the state commissions representing the interests of the states making up the RHC region will be considered, while preventing the FCC from overriding the safeguards and other conditions which the state members felt were necessary. Once in place, such regional Joint Boards could become the vehicle for entertaining other major issues of regional importance, such as uniform access tariffs, regulation or deregulation of regional competitors, deaveraged rates, and RHC acquisitions of independent telephone companies.

STATEMENT OF GEORGE M. MINOT, SENIOR VICE PRESIDENT, COMPUSERVE INC.

My name is George Minot, and I am Senior Vice President of CompuServe Incorporated. CompuServe is one of the nation's largest commercial vendors of electronic mail, value added network (VAN), remote computing and information services. CompuServe's customers reach CompuServe's packet switched network and computer facilities through local exchange facilities furnished by the Bell Operating Companies ("BOCs") and the GTE Operating Companies ("GTOCs") and through facilities furnished by AT&T, Tymnet, Telenet and others. CompuServe relies almost entirely on BOC and GTOC local facilities to route its information services to its customers, and it relies almost exclusively upon AT&T for carriage of its interexchange traffic. Thus, it is vitally concerned with the proposed legislation ("the Dole bill") which would shift the responsibility for administering, enforcing and modifying the AT&T and GTE consent decrees from the courts to the Federal Communications Commission ("FCC").

CompuServe is convinced that there is no need at this time for legislation which would modify the AT&T *Modified Final Judgment* ("MFJ") and the GTE consent decree or which would transfer jurisdiction for the modification and enforcement of these decrees to the Federal Communications Commission. In regard to the MFJ—the decree of most concern to CompuServe and other information service providers—the Department of Justice (with the assistance of its consultant Peter Huber) is examining some of the fundamental issues which the Dole bill and the proposed Danforth amendments address. The Department of Justice has solicited comments from all segments of the telecommunications industry: the BOCs, long distance carriers including AT&T, providers of enhanced services and users. The Department will submit its recommendations to the MFJ court, i.e., Judge Harold Greene, by January 1987. Congress should at the least allow this process to be completed to see what recommendations the Department offers before it takes any action on the proposed legislation.Additionally, the FCC currently is reviewing the comments solicited in its *Joint Cost Accounting* rulemaking. In that proceeding, the FCC proposed various methods of separating the costs of regulated communications service from the costs of nonregulated activities provided by telephone companies and their affiliates. According to the Commission, the "ultimate goal" of the *Joint Cost Accounting* proceeding is to assure just and reasonable rates for communications services that remain subject to regulation by guarding against cross-subsidy of nonregulated ventures by regulated services and to attempt to protect against the injury to competitors which results from cross-subsidization of nonregulated offerings.[1]

Similarly, the FCC currently is conducting proceedings which may also affect directly many of the issues raised in the Dole bill and the Danforth proposed amendments. The primary proceeding is the ongoing *Computer III* rulemaking in which the Commission already has eliminated its structural separation requirements[2] and replaced them with nonstructural safeguards such as requirements for prior FCC approval of the carriers' open network architecture ("ONA") and comparably efficient interconnection ("CEI") plans. Although the Commission has drawn the broad outlines of its *Computer III* regulatory regime in its June 1986 *Report and Order*, the most significant details of its plans to protect ratepayers and competitors from anticompetitive practices remain undetermined. For example, no carrier has yet filed a CEI plan for enhanced services which the FCC and competing providers can examine to determine how AT&T and the BOCs propose to provide a particular enhanced service on an unseparated basis. Moreover, in its *Supplemental Notice* in the *Computer III* proceeding, the Commission solicited further comments on such significant questions as the applicability of the nonstructural safeguards to independent telephone companies and to international services. Also, the FCC is still in the process of developing the parameters of its proposed requirements for disclosure of network information and the proposed restrictions on the BOCs' use of customer proprietary network information ("CPNI").

CompuServe has participated, and will continue to participate, in these ongoing proceedings. I will summarize briefly our position before the Department of Justice and the FCC to show exactly how those proceedings address the same issues as the proposed legislation which the Committee is considering here.

In its comments to the Department of Justice, CompuServe explained why the current MFJ prohibitions on the BOCs' entry into the formation services marketplace should be maintained at this time. First, CompuServe explained that the information services marketplace is comprised of several segments, including electronic mail services, consumer information services and corporate information services. It discussed how some segments of this market are only now becoming competitive or even emerging as distinct segments and that it would be misleading to lump all of these services together and to characterize the entire market as already very competitive and mature.

With that background, CompuServe made the following substantive points:

The receipt and the delivery of all information services are vitally dependent upon the local exchange facilities of the BOCs and GTOCs, and, despite the carriers' attempts to rely on bits of anecdotal information, there has been no significant change in the BOCs' control over bottleneck facilities;

The BOCs and GTOCs have both the motivation and ability to exploit unfairly their monopolistic control of intraLATA communications through potential anticompetitive activities.

CompuServe concluded that if—contrary to CompuServe's recommendatations—the Department of Justice recommended that the BOCs should be permitted to enter the information services market, it is imperative that this action be accompanied by the imposition of stringent structural separation and related requirements. CompuServe showed that the MFJ Court's standard "line-of-business" waiver conditions would not provide sufficient protection against anti-competitive conduct in the information services area.

If the MFJ's "information services" prohibition nevertheless were to be lifted, CompuServe addressed the safeguards that absolutely would have to be already in place prior to any relaxation of the restriction in order to protect ratepayers and competitors. One of the steps that should be taken to reduce the likelihood of BOC descrimination in the installation and maintenance of basic service would be to require the BOCs to process basic service requests (including those from their own information service activities) through their existing centralized operations groups ("COGs"). A second prerequisite is the establishment of a stringent, comprehensive, effective accounting system for allocating joint costs between regulated and unregulated activities.[3] These accounting rules must be very detailed and tailored very specifically in order to prevent cross-subsidy of competitive information services by monopoly services.[4] Equally importantly, whatever rules are adopted must be enforced with vigor and be supported by sufficient resources to ensure stringent monitoring and auditing by the FCC of the information submitted by the carriers as well as on-site spot audits.

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[1] Under the *Computer II* regulator regime, the Commission relied on structural separation as a means to inhibit practices such as cost-shifting between the regulated and nonregulated activities of AT&T and the BOCs.

[2] Under the Commission's *Computer II* rules, AT&T and the BOCs could provide enhanced services and customer premises equipment ("CPE") only through corporate affiliates fully separated from their basic service operations.

A third step should be one similar to the recommendations proposed by CompuServe in its comments in the Commission's *Computer III* proceeding, that is, restrictions on the carriers' competitive use of customer proprietary network information ("CPNI"). At the very least, the customer should be provided advanced written notice of the carriers' intent to use proprietary information and the option to prevent such use or to allow such use conditioned on disclosure to other information providers. Additionally, CompuServe recommended that the carriers' sales and marketing personnel should not be permitted to use a customer's information without advanced written authorization and that the customer should be provided with its own copy of the information that is being provided.

A fourth requirement is the timely disclosure of changes in the network that may affect the provision of information services. Without stringent disclosure requirements, the BOCs could develop and introduce new enhanced services compatible with new network transmission capabilities long before competing providers are made aware of the necessary details regarding the new transmission capabilities. If the MFJ were to be relaxed, the BOCs should be required to disclose network information (a) at the "make/buy" point, *i.e.*, at the time the BOCs decide to manufacture themselves or to procure from an unaffiliated entity any product whose design affects or relies on the network interface or (b) at the very least six months before the new enhanced service is offered. Unlike the FCC's current approach with AT&T, however, the BOCs' obligation to disclose network information should not be conditioned on the willingness of competing information providers to sign "non-disclosure" agreements because it is clear that the BOCs are subject to substantially less competition than AT&T in their provision of network services.

CompuServe provided essentially identical recommendations concerning the need for the implementation of stringent safeguards to the FCC in the context of the *Computer III* rulemaking. Moreover, in response to the Commission's *Supplemental Notice* in that proceeding, CompuServe has opposed the Commission's proposal to treat certain network protocol processing functions that today are classified "enhanced" and, hence, nonregulated, as "neutral" functions that the carriers may provide as regulated adjuncts to their basic service offerings. CompuServe demonstrated that there is absolutely no need for redefining the regulatory status of protocol processing functions because under the FCC's recently adopted *Computer III* regulatory regime the carriers already have received relief from their complaints regarding the claimed inefficiencies of the structural separation requirements. Under *Computer III*, both the physical integration of the carriers' enhanced and basic facilities and the joint marketing of basic and enhanced services will be permitted, subject to nonstructural safeguards. Therefore, changing the regulatory definitions of "enhanced services" and "protocol processing" serves no further beneficial public purpose.

Moreover, if the Commission were to adopt its proposal to treat protocol processing as a "neutral" function, it would disrupt seriously the currently emerging enhanced services marketplace—and even threaten the very survival of new entrepreneurs that today are considering entry into the competitive information services marketplace. First, the Commission's proposed test for distinguishing "neutral" protocol processing from "enhanced" protocol processing is quite ambiguous. The Commission unavoidably would be embroiling itself in unnecessary and continuing controversy over the parameters of its new definitional boundaries, and this continuing regulatory controversy is sure to slow the development of innovative new services or even inhibit their provision altogether.

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[3] We noted in our comments to the Department of Justice that the FCC had initiated the *Joint Cost Accounting* rulemaking to address the difficult allocation issues involved in telephone companies' joint use of facilities to provide both regulated and unregulated activities. We also noted that there is no estimate when that complex rulemaking proceeding will be completed.

[4] As the FCC itself pointed out in applying the structural separation requirements to the BOCs, "accounting separation can often be more difficult to oversee, and can require far more intrusive monitoring efforts than does the monitoring of structural separation conditions . . .." *BOC Separation Order*, 77 F.C.C.2d at 1135. Now that the FCC has already decided to remove the structural separation requirements and rely on the "far more intrusive monitoring efforts" of nonstructural safeguards, Congress must be prepared to allocate sufficient resources to the FCC for it to do the job.

Second, by treating protocol processing as "neutral," certain services now offered on an unregulated basis by value-added networks ("VANs") would be considered as "basic" and thereby subject to regulation by the FCC and also the states. Even the potential regulation of protocol processing services would have a seriously chilling effect on the development of new service offerings by existing providers as well as on potential market entry by new competitors.

Third, by treating protocol processing as a neutral function that could be part of a carrier's basic services, those protocol processing services would not be subject to the Commissions's *Computer III* nonstructural safeguards, such as CEI or the joint cost allocation procedures. For example, the CEI "equal interconnection" requirements are triggered only when AT&T or a BOC offers a non-separated enhanced service. In effect, the Commission would be eliminating the *Computer III* nonstructural safeguards at the same time that it has just eliminated the *Computer III* structural separation requirements. The complete dismantling of all safeguards would place enhanced service providers not affiliated with AT&T or the local exchange carriers at a severe competitive disadvantage.

A final point that CompuServe would like to bring to the Committee's attention is CompuServe's continued support for the MFJ's prohibition of AT&T's entry into the electronic publishing industry for a period of seven years after the effective date of the decree.[5] The MFJ Court found that the electronic publishing industry is still in its "infancy." While electronic publishing has begun in the past several years to emerge as a competitive industry, the Court's fundamental concern is still valid at this time. There can be no doubt that if AT&T entered this market, the combination of AT&T's financial, technological, manufacturing, and marketing resources might well dwarf any efforts of its competitors who are only now beginning to gain acceptance in the marketplace. Beyond that, AT&T's entry into the electronic publishing market poses a substantial danger to First Amendment values. AT&T's potential control of electronics publishing would exacerbate the continuing trend of the concentration of control over the news media. As the MFJ Court stated, "it is not at all inconceivable that electronic publishing with its speed and convenience will eventually overshadow the more traditional news media" in providing information to the American public. The Committee should be concerned, of course, that the competitive marketplace be allowed to develop so that a single electronic publisher could not acquire substantial control over the provision of news in large parts of the United States.

In conclusion, I would like to thank the Committee for providing this opportunity to interested parties to submit comments on the Dole bill and its proposed amendments. I reiterate CompuServe's belief that any legislative action would be premature at least until such time as the Department of Justice and the FCC complete the ongoing proceedings which I have described. In any event, if CompuServe can be of further assistance to the Committee in its consideration of the proposed legislation, we would be pleased to do so.

Thank you again.

STATEMENT OF EUGENE F. MURPHY, PRESIDENT, RCA COMMUNICATIONS, INC.

Chairman Danforth and members of the Committee, on behalf of RCA Communications, Inc., I am submitting the following statement for the record of the Committee's hearings on S. 2565, The Federal Telecommunications Policy Act of 1986.

Unlike the Bell Operating Companies (BOCs), RCA's communications companies serve intensely competitive markets, which generate only a fraction of the revenues produced by the monopoly services offered by the BOCs. Also, unlike the BOCs, we do not control essential local facilities, but must ourselves rely on local facilities provided by the BOCs for the "last mile" between our operating centers and our customers. Indeed, RCA's communications companies and their competitors remain virtually as dependent upon the BOCs for customer access as they did in 1982, when the MFJ was issued.

SUMMARY

For the reasons noted herein, we strongly believe that any legislation respecting administration of the line-of-business restrictions on the BOCs would be premature and unwarranted.

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[5] *See U.S.* v. *American Telephone and Telegraph Co.*, 552 F.Supp. 131, 180-186 (D.C.D.C. 1982).

THE LINE OF BUSINESS RESTRICTIONS CONTINUE TO BE NECESSARY

We believe that the practical realities of the U.S. communications marketplace make the line-of-business restrictions necessary, so long as the BOCs retain their bottleneck monopolies over local access facilities. These facilities are the essential link that all non-BOC service providers must utilize to reach their customers. Because anti-competitive dangers are inherent in a situation where the monopoly supplier of an essential facility to another service supplier is also its competitor, the restrictions should not be modified.

The MFJ permits the restrictions to be removed only where "there is no substantial possibility" that a BOC could use its monopoly power to impede competition. As long as other suppliers, such as RCA Communications' operating companies, remain dependent upon the BOCs' local monopoly distribution services, the BOCs cannot meet that standard.

The BOCs have a unique ability to increase special access costs, while lowering the rates of any end-to-end services that they are allowed to offer. This ability would give the BOCs' interexchange services a market advantage no other firm could match, resulting not only from their size and integrated operations, but from their control over their competitors' access costs.

In addition to the threat of cross-subsidies, the prospect of entry by any BOC into the interexchange and international markets served by RCA's communications companies could have other significant adverse consequences. For example, by reason of their control over the physical interconnection between RCA's operating centers and customers, which the BOCs inherited from AT&T's government-sanctioned monopoly, they are in a position to affect access to RCA's customers, making BOC-provided services more attractive to users.

Neither tariff regulation nor cost allocation methods can be relied upon to alleviate the threat posed by the BOCs to competitive communications. Several FCC officials testified in the divestiture case that the Commission lacked the resources and the ability to monitor the Bell companies. Today, the Commission devotes even fewer resources to rate regulation and has greatly expanded pricing flexibility to dominant carriers. At the same time, cost allocation methods serve only to separate the costs of basic services from those of "enhanced" services. Those requirements would not restrict the BOCs' ability to subsidize their long-distance basic services from their local basic services and access service revenues.

The diversity and quality of specialized interexchange and international communications services have not been diminished in any way by the MFJ restrictions. The markets we serve have been and continue to be dynamic and fully competitive. Consumers enjoy low rates, high-quality services and a wide range of offerings.

To underscore the dangers inherent in any MFJ legislation, it should be noted that one of the MFJ restrictions bars AT&T from acquiring any BOC. Certainly, that restriction should remain inviolate, if the essential goals of the divestiture decree are to be preserved. If that restriction should be maintained, it is difficult to defend relaxation of the corresponding bar against BOC entry into interexchange services.

LEGISLATION WOULD BE PREMATURE

Evidence warranting Congressional intervention now affecting the line-of-business restrictions is conspicuously absent. In January 1987, the Antitrust Division of the Department of Justice is scheduled to make its first report and recommendation to the MFJ Court as to the continuing need for the line-of-business restrictions.

Depending on the court's response to this report, and the views of other parties, whatever need may be perceived for this legislation may well be obviated. In addition, the FCC will shortly be clarifying and then implementing *Computer III* cost allocation standards. While these do not purport to be comprehensive, they nevertheless will have a bearing on the extent to which safeguards in the MFJ must be preserved. Congress should accordingly, at a minimum, stay its hand in enacting legislation affecting the content or administration of there restrictions while they are under judicial consideration.

In the interim, the experience of judicial administration of the MFJ has been positive. The court has denied remarkably few line-of-business waiver requests and has issued its decisions expeditiously. Furthermore, the standards of the MFJ permit a variety of policy considerations to guide the decisions of the court on waiver requests. Thus, there is no basis for Congressional concern that important policy considerations are being overlooked in the present administration of the decree.

CONCLUSION

We believe this legislation to be unwarranted and premature. If, notwithstanding these views, the Congress proceeds with this bill, we hope the Committee will establish safeguards and whatever other measures may be necessary to achieve the stated goals of the legislation with the minimum amount of competitive harm and dislocation.

STATEMENT OF CHARLES M. MEEHAN ON BEHALF OF THE UTILITIES TELECOMMUNICATIONS COUNCIL

My name is Charles M. Meehan. I am General Counsel of the Utilities Telecommunications Council (UTC) which is a non-profit trade association consisting of approximately 2,000 electric, gas and water utilities. UTC is the national spokesman on telecommunications matters for these energy utilities. This testimony addresses the question raised at page four of Senator Danforth's proposals concerning what interconnection requirements should be set forth in the legislation. There are two aspects of interconnection which need to be addressed:

First, it should be made clear that the requirements of telephone companies to provide non-discriminatory interconnection also apply to private telecommunications systems.

Second, it should be made clear that in order to continue the uniform, nationwide policies of the FCC for private telecommunications system interconnection, the FCC has exclusive jurisdiction.

WHY A UNIFORM, NATIONWIDE, NONDISCRIMINATORY INTERCONNECTION POLICY FOR PRIVATE TELECOMMUNICATIONS SYSTEMS IS IMPORTANT

Reliable telecommunications are essential for the operation of energy utility systems. Energy utilities have always relied upon a mixture of private and common carrier facilities to meet their unique internal and external communications needs. Up to now, private land mobile radio, private microwave and power line carrier systems have been the workhorses of the utilities' private communications systems. In the future, we will see an increased use by energy utilities of private satellite earth stations. Similarly, there will be increased use of private fiber optics systems as a means to solve the severe frequency congestion problem which exists in the private microwave bands. It is important that energy utilities continue to have uniform and non-discriminatory treatment in the interconnection of their private systems to the public switched telephone network. Such interconnection is important, particularly in emergency situations where, for example, severe weather conditions or other disasters often disrupt or overload common carrier provided telecommunications facilities serving a particular energy utility operation or plant. Critical telecommunications requirements involving energy utility personnel and those requiring access to the public switched network can often be provided only through private communication facilities that are connected to the public network at remote locations of the utility's choosing reflecting its operational requirements. The freedom to interconnect at remote locations of the utility's choice is critical to safety and reliability since energy utilities require such interconnection during power failures and other emergencies. Nuclear plant operators require remote interconnection for safety communications in the event of an incident at the plant. The day-to-day operations of energy utilities, such as power pool operations, customer service (*e.g.*, trouble calls) meter reading and energy audits also require interconnection at points of the utility's choosing. Selection of the point of interconnection is based upon performance and reliability considerations such as the availability of adequate circuits, outage experience, speed of restoration, quality of circuits and type of service required.

Also, due to the nature of energy utility telecommunications system requirements, it is important that there be a single, unified, nationwide policy with regard to interconnection. For example, the flow of gas over interstate pipelines, the delivery of water over interstate irrigation/supply systems and the flow of electricity over the interstate, interconnected electric grid are controlled and protected by private communications systems, especially microwave, which are interconnected at various points of the utility's choice to common carrier facilities. A myriad of different, and perhaps conflicting, state policies on interconnection would jeopardize communications reliability.

NON-DISCRIMINATORY INTERCONNECTION REQUIREMENTS SHOULD APPLY TO PRIVATE TELECOMMUNICATIONS SYSTEMS

In paragraph six at page three of Senator Danforth's proposals, it was stated that the Federal Communications Commission (FCC) shall implement regulations requiring non-discriminatory provisions of access and interconnection by a telephone company to "its competitive affiliate and other competitors." The language "other competitors" would seem to confine the requirement for non-discriminatory interconnection to other common carriers. Section 5 of S.2565 (and the AT&T Consent Decree) provide that telephone companies shall not discriminate between dominant interexchange carriers and their affiliates and *other persons* in providing interconnection. The term "other persons" would cover operators of private telecommunications systems. This reflects current FCC policies requiring non-discriminatory interconnection of private systems. Confining the bill's interconnection provisions to common carriers could give rise to the argument that the FCC need not continue to require non-discriminatory interconnection of private systems. UTC urges, therefore, that the bill as enacted and the accompanying report language make it clear that any FCC regulations regarding non-discriminatory provision of access and interconnection by a telephone company extend not only to its "competitive affiliate" and "other competitors," but also, to "other persons," such as electric, gas and water utilities which operate private land mobile, microwave, power line carrier, satellite or fiber optics telecommunication systems.

This could be accomplished by employing the language found in Section 5 of S.2565 which required non-discriminatory interconnection for carriers and "other persons." Also the following report language would further clarify Congressional intent:

It is the Committee's intent that the requirement for non-discriminatory interconnection extends not only to telephone companies' competitive affiliates and other competitors, but also to other persons such as operators of private land mobile, microwave, satellite, power line carrier and fiber optic telecommunications systems.

FCC SHOULD HAVE EXCLUSIVE JURISDICTION OVER INTERCONNECTION POLICY

It is important that there be a uniform, nationwide policy for the interconnection of private telecommunications systems. To accomplish this goal, the FCC must continue to have exclusive jurisdiction over such interconnection policies. As was suggested in the legal memorandum accompanying S.2565 when introduced by Senator Dole (See *Congressional Record*, July 18, 1986 at S. 7751), this exclusive jurisdiction in the FCC could be reiterated by Congress making it clear that the restrictions of 47 U.S.C. 152(d) do not apply to the FCC's jurisdiction under this bill. In addition, with respect to interconnection policies for *radio frequency* based private systems, this has already been accomplished by Section 202(b) of the Communications Act. That section provides the FCC with exclusive jurisdiction over common carrier facilities and services *incidental to radio communications of any kind*. The FCC and federal courts have ruled that this applies even to telephone lines which are wholly interstate. This interpretation was codified in the 1960 amendments to Section 202(b). *See*, 105 Cong. Rec. 6253 (daily ed. April 20, 1959). In enacting Section 202(b) Congress has statutorily defined common carrier facilities which are incidental to "radio communications of any kind" as being interstate in nature. Thus, since the restrictions of 47 U.S.C. 152(b) (as well as those in 47 U.S.C. 221(b)) apply to *intrastate* common carrier systems, these restrictions are not applicable to the FCC's authority over the interconnection policies governing local telephone facilities used to interconnect radio frequency based private telecommunications systems. (For further details see the August 22, 1986 memorandum to the FCC staff.)

Seizing upon recent court reversals the FCC has suffered concerning the preemption of state regulation which interfered with FCC policies, some telephone companies are attempting to negate the FCC's exclusive jurisdiction to establish a uniform, nationwide policy on the interconnection of private telecommunications systems. (*See* my letter of July 18, 1986 to Senator Danforth which is attached.)

Thus, it is important that the Committee take this opportunity to stress that under any authority provided to the FCC in this bill and under that already found in Section 202(b) of the Communications Act, the FCC has *exclusive* jurisdiction over interconnection policies for private telecommunications systems. The relief UTC seeks could be accomplished by report language as follows:

The Committee wishes to take this opportunity to stress that under the authority provided in this bill as well as that given under Section 202(b) of the Communications Act, the FCC has exclusive jurisdiction over common carrier facilities and services used to interconnect private telecommunications systems.

Thank you for this opportunity to provide comments on this legislation.

UTILITIES TELECOMMUNICATIONS COUNCIL,
Washington, DC, July 18, 1986.

Hon. JOHN C. DANFORTH,
Chairman, Senate Committee on Commerce, Science and Transportation, Washington, DC.

DEAR CHAIRMAN DANFORTH: Following up on my letter of July 3 concerning your investigation of possible changes in the handling of the Modification of Final Judgment (MFJ), such as proposed in S. 2565, this is to bring to your attention additional documentation as to why it is absolutely essential that the Federal Communications Commission (FCC) be freed from the shackles of 47 U.S.C. 152(b) should it be given authority to make revisions on the restrictions in the MFJ. You will recall that in my July 3 letter I pointed out that any state public service commission meddling in the interconnection of private microwave facilities to the Public Switched Telephone Network (PSTN) could have disastrous results and that we were concerned that telephone carriers and public service commissions (PSCs) would use the *Louisiana* Case to restrict the use of private microwave, in particular, freedom of interconnection. In this regard, there is a case now pending before the FCC concerning the interconnection of Atlantic Richfield's (ARCO) private microwave system. In essence, due to operating necessities, it is important for ARCO to be able to interconnect its private microwave system at a central office remote from the ARCO operating facilities served by the private microwave system. The local telephone carrier and the Texas PSC have opposed ARCO's right to interconnect where it chooses. To date, the FCC has supported ARCO's right to interconnect where it wishes and has preempted state regulation. The trade association representing the PSCs, the Texas PUC and General Telephone Company of the Southwest (General) have filed pleadings with the FCC indicating that the *Louisiana* Case ruling on 47 U.S.C. 152(b) negates the FCC's authority to permit ARCO to interconnect where it desires to do so to meet ARCO's own operating needs.

I am enclosing a filing we made with the FCC in this case on behalf of UTC, which as I indicated in my July 3 filing is the national spokesman on telecommunications matters for some 2,000 electric, gas and water utilities operating throughout the United States.

If the state PSC's or local telephone companies are able to dictate where and how operators of private microwave systems interconnect, as is being urged by the PSCs and the telephone carriers in the ARCO case, it could have absolutely disastrous results in the utility industry in terms of adverse impact on the reliability of electric, gas and water service to the American public. In the case of nuclear plant facilities, it could be even worse, since it is essential electric utilities operating nuclear plants be able to interconnect their private microwave facilities at central office facilities remote from the plant since in a nuclear incident the central office serving the plant would soon become saturated.

I am bringing this additional information to your attention as further support for strong language in S. 2565 and the accompanying report that the restrictions of 47 U.S.C. 152(b) should not apply to the FCC's authority under that bill.

More importantly, Senator Danforth, I suggest the Commerce Committee may want to consider whether or not it might be in the public interest to substantially modify the impact of 47 U.S.C. 152(b) as it is presently written. Quite frankly, in light of the fact that we are dealing with a single, nationwide telephone system comprised of a multitude of service providers, it seems to me that the need for and desirability of exclusive state regulation as is contemplated in 47 U.S.C. 152(b) may not be as strong now as it was in 1934. While a general analysis of the need for that section is probably beyond the scope of your current investigation, it might certainly be a matter for further study, say during the next session.

I suggest that the ARCO case be watched very carefully by the members of your Committee. If, under the Communications Act as it is presently written the state PSCs and local telephone companies can dictate to private microwave users how they may interconnect their private systems, I can assure you there will be a groundswell of public opinion to revise the Communications Act to remedy such a disastrous situation.

Should you have any questions concerning any of these matters, please let me know.

Cordially yours,

CHARLES M. MEEHAN, *General Counsel,*
Utilities Telecommunications Council.

STATEMENT OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

Mr. Chairman and Members of the Committee, I am Jack Shreve, Florida Public Counsel, and I am submitting these comments on behalf of the National Association of State Utility Consumer Advocates ("NASUCA"). NASUCA is an organization of officials from 38 states and the District of Columbia who are charged by state law to represent the interests of their citizens in utility matters.

THE MODIFIED FINAL JUDGMENT

Our members have been quite pleased with the efforts taken by Judge Harold H. Greene to promote the best and least costly local telephone service to the American public. As a matter of practicality it has been clear to us that the actions taken by Judge Greene have been more favorable to the consumer than the actions taken by the Federal Communications Commission ("FCC").

At a time when the Bell Operating Companies are clamoring to be released from the requirements of the Modified Final Judgement, it is significant to recall the silence of the Bell Operating Companies about these matters in the public interest proceeding held before Judge Greene. In that proceeding, not one of the designated chief executive officers of the soon-to-be established regional companies suggested or intimated that, in addition to the local monopoly role assigned to them by the decree, the companies needed, required, or were at all interested in providing interexchange or information services.

Nevertheless, the decree has a built-in review mechanism to look again at the line of business restrictions. In January of 1987 the Justice Department will present the Court a review of the telecommunications markets and a possible need for changes in the Modified Final Judgement. It thus appears premature at this time to eliminate the jurisdiction of the District Court without the benefit of this review by the Justice Department and the Court.

LEGISLATIVE PROPOSALS

If Congress should transfer the jurisdiction of the Modified Final Judgement from the District Court to the FCC, the highest priority should be given to incorporating ratepayer protections in the legislation itself. We view the proposal of Congressman Ron Wyden as offering the best protection against the natural inclination of the telephone companies to subsidize its unregulated activities by inappropriately shifting costs to its regulated activities.

THE NEED TO PROTECT AGAINST CROSS-SUBSIDIES

Several months ago Joel Blau, director of utility intervention for the New York State Consumer Protection Board, testified before the House Subcommittee on Telecommunications, Consumer Protection and Finance concerning the experience of his office with cross-subsidization by Rochester Telephone Corporation. A copy of that testimony is attached to these comments.

Briefly, New York regulators found a pattern of pervasive subsidization from the regulated monopoly to benefit a competitive subsidiary. The New York Public Service Commission Staff quantified tangible subsidies of $7.6 million between 1979 and 1983, compared with the subsidiary's earnings of $7.2 million in that same period. Instances such as this make it crystal clear that strict controls will be needed to prevent cross-subsidization if the line of business restrictions are eased.

NASUCA has also participated extensively in proceedings before the FCC concerning the allocation of costs between monopoly operations and competitive ventures of the telephone companies. I have attached to these comments a copy of the pleading NASUCA submitted to the FCC on this matter to show the magnitude of the efforts required to minimize cross-subsidization.

We feel the provision of Congressman Wyden's proposal requiring the allocation of joint and common costs to information services is absolutely necessary to reduce the likelihood monopoly ratepayers would wind up subsidizing the ventures of the Bell Operating Companies into information services.

COMPENSATION FOR INTANGIBLE BENEFITS

This provision of Congressman Wyden's proposal is particularly important because it recognizes the considerable intangible benefits the competitive activities receive as a result of their utility affiliation. The competitive enterprises of the telephone companies instantly receive the benefit of the telephone company's reputation, credit standing, revenue and earnings stability, and personnel trained over the years at ratepayer expense. Earlier this year the California Public Utility Commission recognized this flow of intangible benefits in a decision concerning an application of San Diego Gas and Electric Company. Congressman Wyden's proposal likewise recognizes this very real, yet difficult to quantify, flow of benefits. Its recognition is essential for ratepayer protection.

FEDERAL-STATE JOINT BOARD

Finally, we agree with Congressman Wyden's proposal to establish a joint rulemaking board to promulgate regulations concerning compliance with his ratepayer protections. State regulators are directly accountable to their citizens when the telephone companies request higher local rates. Typically, state regulators will travel throughout a state to receive customer input prior to actually holding hearings on a rate request. In contrast, the FCC normally holds no hearings at all. Instead, it merely accepts written comments during what is often a very short time frame. A joint board, allowing state regulators to work in conjunction with the Commissioners of the FCC, would allow a better balance in the oversight of the potential entry of the Bell Operating Companies into new lines of business.

To summarize, we believe any legislation transferring jurisdiction of the Modified Final Judgement from the District Court to the FCC is premature in view of the impending review of the Modified Final Judgement by the Justice Department and the Court. However, if legislation is adopted, the proposal of Congressman Wyden focusing on ratepayer protections is the best alternative.

STATEMENT OF THE NATIONAL RURAL TELECOM ASSOCIATION

The National Rural Telecom Association (NRTA) appreciates Chairman Danforth's invitation to interested parties to submit written testimony on S.2565 and other pending legislation relating to whether, when and how the Bell Operating Companies (BOCs) should be allowed to compete in additional telecommunications markets. There are indications that some participants think that this issue affects only the companies that are the direct subject of the proposed legislation, not other local exchange companies such as NRTA's members. This is not the case. NRTA's purpose in commenting is to alert the committee to the urgent need for careful and explicit protection of rural telephone companies and their customers to prevent legislation to strengthen the BOCs from severely injuring rural telephone service.

SUMMARY

NRTA is a national trade association consisting of about 300 commercial local exchange telephone companies that serve telephone customers in rural areas scattered throughout the United States, using financing provided under Rural Electrification Administration (REA) programs. NRTA's REA Borrower members are companies that came into existence as a result of government programs developed because marketplace economics did not lead to universal telephone service for rural consumers. Moreover, many rural customers have affordable local and long distance telephone rates right now only because of support arrangements developed in a monopoly environment and maintainable in a competitive environment only through sufficient regulatory involvement to forestall "marketplace failure."

Unleashing the BOCs to compete in the interexchange telecommunications market will very substantially increase the economic incentives to reduce essential network support for (a) affordable local rates in rural areas and (b) average toll rates. It will also subject rural areas to the threat of bypass by their few, but critically important, business customers, leaving still higher costs to be recovered from the relatively few remaining rural subscribers and causing uneconomic stranded investment. Rural areas are already least likely to obtain the benefits of interstate long distance competition and most dependent on maintaining their traditional protected local franchise status. Congress should not adopt legislation that will further erode the conditions that have made affordable and reliable service slowly become a reality for many rural Americans. To prevent this will require carefully tailored and effective safeguards, at the very least.

INTRODUCTION

The Dole Bill, S. 2565, proposes to give the Federal Communications Commission (FCC) control over enforcing, revising, or eliminating the restrictions placed on what business activities are open to the Bell Operating Companies in the wake of the court-approved AT&T divestiture. Up to now, Judge Green, the federal district court judge that accepted the antitrust settlement between the United States Department of Justice and AT&T and oversaw the divestiture, has been supervising the ongoing restrictions in the divested BOCs.

The consent decree prohibits the BOCs from engaging in certain businesses, including interexchange telecommunications services. The BOCs, chafing under this and other restrictions accepted as part of the antitrust settlement, have had very limited success in persuading Judge Green to relax the consent decree restrictions. The FCC, on the other hand, is known to favor wider latitude for the BOCs. Therefore, it is virtually certain that the FCC would take immediate steps towards allowing the BOCs to provide interexchange communications services that are now prohibited.

Independent local exchange companies like NRTA's members were not involved in the litiation that led to the AT&T consent decree, and were not subject to its terms. Nevertheless, the implementation of the decree has had profound and often adverse effects on independent companies, particularly in rural areas, and their subscribers. It would be highly inappropriate to increase or reaffirm unfair adverse impacts on rural interests flowing from the decree here, rather than taking this opportunity to rectify them.

NRTA's concern is not so much with who determines what the BOCs are allowed to do or whether the restrictions should be relaxed as with assuring that rural companies and their subscribers are not driven further into the role of competition's losers, owing to a headlong rush to embrace the imperative of the competitive marketplace. Reliance on competition alone as a regulator is not naturally conducive to fulfilling the public interest in rural service. Chairman Danforth has identified the importance of protecting universal service in legislation dealing with further BOC competition. That concern merits thorough exploration and positive action.

Although Senator Dole and 31 other senators were previously instrumental in persuading the FCC to take a careful look at the impacts on consumers of access charge policies intended to accommodate increased competition and implement the AT&T divestiture, Senator Dole's Bill directs (Sec. 6) that the restrictions on BOC interexchange services "shall be removed by the Commission upon a showing . . . that there is no substantial possibility that the petitioning [BOC] could use its monopoly power to impede competition in the market it seeks to enter . . .."

Despite some general public interest references in the bill and in descriptions of its provisions, it is plain that the proposal equates the public interest with maximizing competition, not balancing the enlarged competition with other relevant factors.

The more complicated relationship between competition and the public interest in rural areas requires extensive further investigation and evaluation of benefits, not simple assumptions. Rural telephone companies and rural subscribers have typically not been the beneficiaries of the competition ordered by the FCC so far. Instead, changes in policies adopted to foster competition are already generating higher exchange rates for rural residents, with few compensating gains. For them, lower toll rates are a poor substitute for increasing local rates, and deaveraged toll rates would do away with even the limited advantage of toll rate reductions.

Federal and state regulators throughout the country are being pressed to reduce still further the "subsidies" inherent in treating the network as a whole, so that companies may compete on particular routes and even for particular customers. Regardless of the long term validity or vitality of the economic theories that are now accepted, applying such concepts as "cost causation," concentrating cost recovery on the "lease elastic service," and other popular rubrics means, in rural areas, that rates increase, but consumer choices in interexchange providers and services do not.

The reasons for this are economic. Rural telephone service is more costly to provide than service to concentrated urban centers. First, it takes more wire and more labor to construct facilities to individual farms many miles from the telephone company's central office than to link relatively closer customers to an urban officer. In addition, many telephone construction and operating costs are "density sensitive," that is, the cost per household or business is lower for facilities that are designed to serve a large number of customers or traffic. If rural telephone subscribers had to pay all the individual costs associated with their service on a customer-by-customer, exchange-by-exchange or telephone company-by-company basis, their rates would be too high for many families, individuals and small businesses to afford.

The marketplace does not foster rural service on its own. Indeed, the need for REA financing became apparent to Congress in the first place in the late 1940s because private businesses operating under marketplace incentives were not able to build telephone facilities to serve rural area. Capital was not available where companies could not charge rates that would recover their costs and a reasonable profit. Even the REA financing programs that make financing available to construct telephone facilities to serve rural areas include a requirement to serve whole rural areas, rather than only their more economically attractive parts. This Committee should exercise great care not to undermine the important benefits for rural areas that have been achieved under the REA programs.

Telephone service is extremely important for rural residents and businesses. Obtaining basic supplies and health care, as well as developing and strengthening social and community contacts, depend much more on telephone use when people and businesses are far apart. There are fewer businesses in rural areas to begin with; those there are need reliable and inexpensive telephone service to conduct their business activities. Economists have confirmed the value and importance of rural telephone support to rural economic growth, to the nation as a whole, and to all telephone users.[1] Marketplace behavior does not reflect these "external" benefits: There are few economic incentives to enter a rural market if all costs must be paid by the small business and residential customer base there. The drive to increased competition, thus, holds out the least benefit to those in high cost rural areas.

Telephone companies faced with competition by other firms that are free to choose only the most economically attractive markets are driven to attempt to "deload" the costs of higher cost markets from their rates. The FCC has already responded to such pressures by shifting more of the costs of service to subscribers so that carriers can compete on grounds which do not reflect socially valuable but economically "distortive" support for nationwide average toll rates and local rates that do not reflect the full costs of service in high cost locations. Moreover, the BOCs have been increasingly successful as advocates of deaveraging state toll rates and shifting to "bill and keep" (individual company-based) cost recovery arrangements rather than statewide (network-based) cost and revenue sharing mechanisms. Rural companies and customers are the losers in the rapidly emerging economic model.

If the BOCs enter the interexchange toll arena, their economic incentives to replace network (or all-customer-based) cost recovery with an individual company and individual customer focus will become even more overwhelming. Unrelenting pressure to abandon high cost local service areas to their own fate—high local rates and deaveraged toll rates—will be a likely consequence in the absence of regulatory measures. The evidence in many economists' statements in regulatory proceedings and elsewhere is that such a result is entirely consistent with competition, and is actually a positive benefit when viewed through the lens of the economic theoretician. The FCC must be bound by Congress to a more socially legitimate test of the public interest, if it is to be entrusted with unleashing the BOCs into the already chaotic interexchange marketplace.

The enormous potential detriments for small and rural companies and customers from BOC expansion into the interstate and intrastate interexchange markets do not stop with the great economic pressure to reduce support for nationwide universal service. The BOCs would also obtain the incentive and the authority to divert the relatively few large customers that small rural exchange companies serve.

From the point of view of recovering the higher costs of rural service, each business that provides substantial telephone revenues to the local exchange company serving a rural area is more important to the company than is any single customer in an urban area with many large business customers. If one such customer "bypasses" the local telephone company's network, the costs it leaves behind force the rates of remaining customers to rise to cover the operating costs that remain. There are fewer ways to use idled capacity in rural areas, so stranded investment is a likely result of losing customers. Further upward pressures on rural rates would follow.

Right now, AT&T is the worst bypass threat for small local exchange companies in rural areas. For example, AT&T's Megacom tariff offers large local access customers the opportunity to connect directly with AT&T. Entry of the local BOC would greatly increase this bypass danger. Long distance competition generally is not attracted to rural areas because there is not enough potential traffic to persuade newer long distance companies to build new facilities into the area to compete. AT&T and the BOCs have served rural America's toll needs because it was feasible to develop nation- and state-wide toll service in a monopoly environment when costs could be spread across the whole network. Thus, they already have a presence in the rural areas.

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[1] *See*, Edwin B. Parker, *Economic and Social Benefits of the REA Telephone Loan Program* (1981); Robert D. Willig, *The Continuing Need For And National Benefits Derived From The REA Telephone Loan Programs—An Economic Assessment* (1981).

As toll competitors, AT&T's and the local BOCs' purely economic incentives would be to discontinue service to high cost areas, other than for the few economically attractive customers. Under requirements also surviving from the monopoly environment they cannot cease to serve without state or federal regulatory permission. However, where two companies are in a position to serve, it is harder to point to a "carrier of last resort." Moreover, one of the basic characteristics of a truly competitive marketplace is freedom of exit as well as freedom of entry. That kind of economic "benefit" does not bode well for rural consumers or rural exchange companies.

The Dole Bill also gives the FCC authority to remove restrictions on the BOCs without reference to the limitations on its jurisdiction under Section 2(b) of the Communications Act. If the FCC interpreted this to enable it to authorize full local exchange competition by the BOCs outside their own areas to relax the current prohibitions on their non-monopoly services, the consequences for local exchange service in neighboring areas could be severe. Chairman Fowler has already publicly expressed his support for unrestricted local service competition. Diversion of any large concentration of service that exists in a small exchange area—for example, a residential development, a seasonal resort, a downtown business network—if a BOC provides competing local exchange communications could have devastating consequences for the rest of a rural exchange area. Once the lowest costs and most efficient portion of the area had been captured, the unit costs to be recovered from the small remaining subscriber population could be astronomical.

NRTA sees in the Dole Bill and other related legislation looking towards giving the BOCs *carte blanche* to provide interexchange services a very severe threat to reliable and affordable rural telephone service. It would be a grave mistake either (a) to regard this as an issue that affects only the local exchange industry or (b) to conclude that resolving the issue of BOC expansion in a vacuum can provide a coherent policy solution that would live up to the bill's comprehensive title, the "Federal Telecommunications Policy Act of 1986."

In short, Congress should not place a decision of such moment for rural telephone subscribers and companies in the hands of the FCC without fully evaluating the likely consequences for rural service and imposing a clear duty and concrete safeguards to protect rural subscribers and companies. In particular, the Committee should not rush to judgment on the basis of hasty and incomplete evaluations. There is no need for the breakneck legislative pace at which Congress is being urged to act here. Industry reorganization designed to benefit big business customers and metropolitan telephone operations must not be allowed to undermine high quality, reliable and affordable rural service. NRTA strongly urges this committee to see that this does not happen.

STATEMENT OF THE NATIONAL TELECOMMUNICATIONS NETWORK

The National Telecommunications Network ("NTN") appreciates this opportunity to respond to Chairman Danforth's request for additional comments concerning S. 2565, the Telecommunications Policy Act of 1986, and proposed amendments thereto. NTN is a joint venture of seven regional long distance companies who together have invested approximately $750 million to construct and operate a 12,000 mile national fiber optic network.[1] The members offer a wide range of long distance services in competition with AT&T, MCI, US Sprint and other interexchange carriers.

These comments supplement NTN's previous statement, submitted on July 3rd of this year, which addressed in more detail questions of jurisdiction over the Modification of Final Judgment ("MFJ") and the continuing necessity for restrictions on the Bell Operating Companies.

In support of S. 2565, the Bell Companies suggest that the bill would "simply" shift certain federal telecommunications regulation from the federal courts and Justice Department to the Federal Communications Commission. In fact, the FCC already performs its telecommunications regulatory role. At issue in this bill is whether the Congress should take the unprecedented action of attempting to strip the federal court of jurisdiction over a landmark antitrust case so that the FCC, with its demonstrated and admitted incapacity to deal with antitrust issues, can follow its predisposition to alter the terms of the court-entered consent decree.

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[1] The seven members of NTN are: Consolidated Network Inc., Matoon, Illinois; LDX NET, Inc., St. Louis, Misouri; LiTel Telecommunications Corporation, Worthington, Ohio; Microtel, Inc., Boca Raton, Florida; SouthernNet, Inc., Atlanta, Georgia; Southland FiberNet, Inc., Pensacola, Florida; and Williams Telecommunications Company, Tulsa, Oklahoma.

Such actions would make a mockery of the antitrust suit and the federal courts, and permit the RHCs to use their monopoly power to cut off long distance telephone competition before it can develop to a viable stage. It would also represent an extreme example of changing the rules in the middle of the game, severely jeopardizing the large investments made by the NTN members and other new enterprises in reliance on the terms established by the MFJ to permit and protect the development of competition. In his testimony before this Committee on September 16, MCI Chairman William McGowan accurately characterized this legislation: "The proposal embodied in S. 2565 to strip the federal court of its ability to enforce an existing injuctive decree is not just a bad idea. It's unnecessary, unfair, unconstitutional, and wholly unprecedented."

Although NTN's opposition to S. 2565 remains unchanged, NTN is pleased to respond to the findings, proposals and questions released by Chairman Danforth on August 28.

I. THE INTERLATA RESTRICTION IS CRITICAL TO THE DEVELOPMENT OF COMPETITION

NTN is best qualified to addess the implications of S. 2565 for its own area of business and expertise, the long distance industry. The restriction against BOC provision of interLATA telecommunications services is the cornerstone of the MFJ—in Judge Greene's words, it is both "logical" and "crucial".[2] Judge Greene heard extensive evidence establishing how the Bell System used its control of local network facilities to prevent competition. As the Committee knows, the MFJ contains two distinct safeguards to address this problem. First, the divested Bell Companies have been required to reconfigure their access facilities to provide AT&T's competitors with interconnections that are equivalent to those AT&T itself receives. Second, the Bell Companies are themselves prohibited from providing interLATA services.

As they complete the "equal access" implementation process (with all of its well-publicized problems), the RHCs are now proclaiming that they should be relieved of the interLATA restriction.[3] But this argument has no merit whatsoever, for the two safeguards are unrelated. Equal access is intended only to put new competitors on the same footing as *AT&T*; the BOCs are under no obligation to provide other carriers with access that is equal to that which they use for their own services, and none have done so.

The interLATA prohibition has an entirely different purpose. It is founded on the indisputable fact that the Bell Companies still have the ability and incentive to use their local network monopoly to injure competition—just as the Bell System did in the past. They enjoy bottleneck control of critical local access facilities between long distance companies and their customers. They have massive ratepayer-supported resources. They control advance information on network planning and development. They have monopoly-derived relationships with all customers, and unique information about customer telecommunications patterns and needs.

NTN does not contend that the Bell Companies should be barred from interLATA service for all time. But that is not what Judge Greene or the MFJ require. The court has made clear that the Bell Companies will be permitted to compete in the interLATA market—but not until the local network bottleneck has dissipated and competitive alternatives have developed for local access to customers.[4]

Unfortunately, public statements of FCC officials lead all observers to believe that, if given the opportunity, the agency may well abandon this standard and risk a return to the anticompetitive conditions which preceded the MFJ. Certainly the RHC officials believe that, or they would not pressing for passage of this legislation. NTN strongly believes that no legislation is warranted at this time—a view shared by the leading telephone user and consumer representatives and virtually everyone else in the telecommunications industry except the RHCs. But at a bare minimum, any legislation that is considered must expressly require the FCC to retain the MFJ's prohibition on interLATA service for as long as the BOCs maintain their bottleneck control over the local network.

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[2] *United States* v. *Western Elec. Co.*, 627 F. Supp. 1090, 1097-98 n. 25 (D.D.C. 1986), *rev'd on other grounds, United States* v. *Western Elec. Co.*, No. 86-5118 (D.C. Cir. Aug. 15, 1986).

[3] Of course, completion of "equal access" is still several years away. As of today 30% of the local access lines in the United States have not been converted to equal access, including many lines in major metropolitan areas.

[4] *United States* v. *Western Elec. Corp.*, 592 F. Supp. 846, 868 (D.D.C. 1984); United States v. AT&T, 552 F. Supp. 131, 194-95 (D.D.C. 1982), *aff'd sub nom Maryland* v. *United States*, 460 U.S. 1001 (1983).

II. THE SAFEGUARDS SUGGESTED BY CHAIRMAN DANFORTH ARE NOT ADEQUATE

Along with others who have testified before this Committee, NTN has concerns relating to the full range of complex proposals and questions released by Chairman Danforth, including proposed FCC procedures and proposals affecting other lines of business. We remain convinced that none of these proposals is an adequate substitute for administration of the MFJ—an antitrust consent decree—by the court that heard the evidence in that case. We also agree with those who contend that any interference with the consent decree would violate constitutional principles of separation of powers. For present purposes, however, we have limited our comments to the issues of critical concern to us, specifically, proposals relating to BOC entry into the interLATA market.

A. Structural Separation

Chairman Danforth has proposed three "additional safeguards" that apparently would have to be met before the Bell Companies would be permitted to offer interLATA services. First, the RHCs would be required to establish separate subsidiaries for their interLATA operations. But structural separation alone cannot prevent the Bell Companies from cross-subsidizing competitive operations with monopoly-derived revenues.[5] As the antitrust court and others have repeatedly observed, regulatory agencies are inherently incapable of preventing the local telephone monopolies from engaging in anticompetitive conduct in other telecommunications markets.[6]

Indeed, state regulators attempting to scrutinize the relations between monopoly and competitive Bell Company affiliates in the months since divestiture have been repeatedly stymied. The California PUC, for example, encountered "deficiencies" in Pacific Bell's responses to repeated PUC inquiries, and it concluded that there were "questions regarding the reliability and accuracy" of information ultimately submitted to it by Pacific Bell. [7]The National Regulatory Research Institute reported a "new, post-divestiture lack of cooperation on the part of the BOCs" which has forced regulatory agencies to resort to expensive and time-consuming court battles to obtain information.[8] And the National Association of Regulatory Utility Commissioners ("NARUC") reported that state regulators have consistently been denied access to RHC data, and have otherwise been frustrated by poor accounting records and deficient transactions standards.[9] These problems have become so severe that NARUC recently has called for new measures to ensure that state regulators can obtain access to the Bell monopolies' records.[10]

But if structural separations do not protect ratepayers even when the regulatory agency is diligent in its scrutiny of affiliate transactions,[11] surely such safeguards cannot be relied upon if consent decree jurisdiction is turned over to the FCC. That agency has systematically abandoned structural separation in most contexts, and has made no effort to encourage it even when companies have offered to observe separation on a voluntary basis.[12] Nor has the FCC itself made any meaningful attempt to determine whether interstate ratepayers are subsidizing separated RHC businesses. Clearly, separation requirements cannot prevent Bell Company abuses of their bottleneck monopoly position—that is why the divestiture remedy was adopted in the first place.

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[5] See Second Computer Inquiry, 77 F.C.C.2d 384, 462 (1980) (separate subsidiary requirement cannot foreclose the possibility of predatory conduct); *United States* v. *AT&T*, 627 F. Supp. 1090, 1112 (D.D.C. 1986), *rev'd on other grounds, United States* v. *Western Elec. Co.*, No. 86-5118 (D.C. Cir. Aug. 15, 1986) (separate subsidiary requirement is not adequate to override the dangers that gave rise to the decree).

[6] For example, during the AT&T trial, former chiefs of the FCC Common Carrier Bureau testified that the FCC suffers from "structural, budgetary and financial deficiencies" which render it incapable of effective enforcement of the laws governing the local telephone monopolies. *United States* v. *AT&T*, 552 F. Supp. 131, 168 (D.D.C. 1982), *aff'd sub nom, Maryland* v. *United States*, 460 U.S. 1001 (1983).

Recently, the present chief of the Common Carrier Bureau, Albert Halprin, expressed his exasperation with the Bell Companies for their lack of cooperation in meeting even their most basic, ministerial obligations under the FCC's tarriff regulations. He stated that the LECs "certainly don't have a uniformly good record on regulatory compliance, and that represents a charitable characterization of the industry's performance * * *. *The fact that the LECs can't get their access tariff filing right seriously undermines their efforts to gain approval for entry into new competitive spheres* * * *." Telecommunications Reports, Aug. 4, 1986 at 10-11 (emphasis added).

[7] Report of Public Staff Division, California Public Utilities Commission, concerning Pacific Bell's affiliate relations, as summarized in Telecommunications Reports, June 23, 1986 at 14-15.

[8] Unregulated Enterprises of the Bell Operating Companies, National Regulatory Research Institute, at 4-5 (March, 1986).

[9] *See* discussion of audit reports released by NARUC in Telecommunications Reports, July 21, 1986 at 8.

[10] Communications Daily, September 19, 1986 at 5.

[11] *United States* v. *Western Elec. Co.*, Civ. Action No. 82-0192, slip op. at 9-10 & n. 10 (D.D.C. Feb. 26, 1986) (California PUC is particularly vigilant of cross-subsidization, but this is not the case in all states).

B. IntraLATA Competition

Chairman Danforth has suggested that any removal of the interLATA prohibition should be conditioned on the elimination of all restrictions on intraLATA competition. This proposal correctly recognizes that the Bell Companies, while seeking removal of the interLATA restriction, have actively worked to block or forestall intraLATA competition with their own operations, and have been successful in that effort in most states. Such actions are directly contrary to the spirit and intent of the MFJ. When Judge Greene approved the large LATAs proposed by the Bell System under the MFJ, he did so only with the understanding that intraLATA competition would be permitted.[13]

However, even if Congress were to require the removal of all barriers to intraLATA competition as one condition of RHC provision of interLATA services, many competitive problems would remain. These problems are clear from experiences in the few locations where intraLATA competition exists today. Even under the MFJ the Bell Companies retain premium access connections which allow them literally to strip off the intraLATA traffic of a customer, even if the customer wishes to use a Bell competitor. The Bell Companies also manipulate access charges to make intraLATA competition economically impossible. In short, they are exploiting their bottleneck monopoly power in just the fashion predicted by Judge Greene and the Justice Department when the MFJ was approved. The universal customer relationships of the BOCs and their numerous other advantages would represent a potentially fatal threat to the development of long distance competition in the interLATA market.

C. Facilities Leasing

Similarly, a requirement that the RHCs lease rather than own interLATA facilities would provide no meaningful safeguard against anticompetitive activity. For one thing, the RHCs already are spending millions of dollars to construct long haul fiber optic networks—all at ratepayer expense and in anticipation of being able to convince the government to remove the interLATA restriction.[14] But a "leasing" requirement would not prevent the RHCs from reaping the cross-subsidies that they have planted. The RHCs would simply "lease" very short network links to cross LATA boundaries, connecting those links to their own networks. Indeed, such "LATA-hopping" already is taking place today on a limited basis.

More important, of course, a "leasing" requirement would do absolutely nothing to prevent the Bell Companies from using their bottleneck control of local access to disadvantage competitors. But that is the core problem that the MFJ is intended to protect against.

NTN respectfully submits that only a flat prohibition on Bell Company entry can protect the environment of developing competition in the interLATA market. This crucial restriction must be maintained until the RHCs lose their monopoly bottleneck control over the local network.

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[12] In the Matter of Application for Consent to Assignment of Licenses and Transfer of Control of Certain Subsidiaries of GTE Corporation and United Telecommunications to U.S. Sprint Communications Company, File No. ENF-86-4 (released June 18, 1986) at 12.

[13] Judge Greene wrote that "the lack of competition in the [intraLATA] market would constitute an *intolerable development.* The opening up of competition lies at the heart of this lawsuit and of the decree entered at its conclusion, and the *significant amount of traffic that is both intrastate and intraLATA should not be reserved to the monopoly carrier.*" *United States* v. *Western Electric Co.*, 569 F. Supp. 990, 1005 (D.D.C. 1983) (emphasis added).

[14] As Judge Greene has recognized, "even to leave open the possibility of Regional Holding Company entry into [the interLATA] market would have negative implications * * * [I]f the companies perceive themselves as future long distance competitors they will have incentives to spend ratepayer funds for long-distance network construction and to position themselves for successful entry by discriminating against other carriers in interconnection and by delaying their achievement of equal access." *United States* v. *Western Elec. Corp.*, Civ. Action No. 82-0192, slip op. at 19 (D.D.C. Feb. 26, 1986); *United States* v. *Western Elec. Co.*, 592 F. Supp. 846, 867 (D.D.C. 1984).

Unfortunately, the Justice Department and the FCC are not preventing such investment today—even in advance of action on S. 2565. These new RHC longhaul facilities are nominally intended for intracompany communications and operator services. Yet, in some cases these investments dwarf those owned by AT&T for all of AT&T's current interLATA traffic.

III. THE RHCS SHOULD REFOCUS THEIR FULL ATTENTION ON LOCAL NETWORK IMPROVEMENTS

NTN submits that, in accordance with the Bell Companies' primary role as providers of local telephone service, these companies should set a goal of universal digital service by 1995, and then devote their resources to that end. Ironically, while the RHCs rush to diversify, they are failing in their obligation to upgrade the local network to reflect current technology. In the long distance market, for example, NTN and other carriers have been rewiring the country with fiber optic cable, ushering in a new era of high capacity, inexpensive and relatively distortion-free digital transmission services. But American business will not be able to fully convert this investment into efficiency and productivity gains until the Bell Companies also construct corresponding digital facilities at the local ends of the network. Similarly, a forward-looking national policy to encourage the RHCs to connect residential subscribers by digital network facilities will help speed new services into the home, and will avoid a division of the country into classes of the information-rich and information-poor.

Unfortunately, however, the RHCs have placed improvements in the local network far down their priority list. Digital access facilities are only being installed slowly and inefficiently. Some believe that the Bell Companies are deliberately delaying network improvements to prevent information providers and new long distance companies from becoming strong, in expectation that Congress or the FCC will soon allow the Bell Companies themselves to enter those businesses. In any event, Congress must remind the RHCs that as holders of the monopoly franchise for local service, they have a duty to keep local service current with new technology. The Bell Companies are deriving record profits from their monopoly-based operations.[15] They should invest those profits in the local network of the future—the digital service future—not simply pass such profits to shareholders and unrelated business ventures.

IV. CONCLUSION

Nothing has occurred since divestiture to warrant Congressional modification of the MFJ, and in particular the interLATA service restriction. The MFJ contains its own review mechanism and, in accordance with that provision, a Department of Justice report assessing the post-divestiture experience is being prepared and will be released at the end of the year. While the Justice Department's new role as an aggressive proponent of S. 2565 may raise serious questions concerning the objectivity of its forthcoming conclusions, there is surely no reason for Congress to act before it has the benefit of this report. The Committee should instead schedule hearings next year both to explore how actively the Justice Department is investigating the Bell Companies under the monitoring and visitorial provisions of Section VI of the MFJ, and to examine the results of the Department's report to the antitrust court.

NTN understands that notwithstanding the above, an attempt may be made to bypass the Committee's processes and attach S. 2565 to another unrelated bill, the passage of which is required by the national interest. But in no event should the Committee permit the vital issues raised by this legislation to be resolved without the opportunity for separate and complete consideration. It would be a special travesty if the power and jurisdiction of the federal courts and the serious antitrust and constitutional issues presented by S. 2565 were evaded through a parliamentary "end-run". Not a single telephone user or any enlightened observer could or would defend such a tactic.

This Committee must instead help ensure that the RHCs are not allowed to enter the interLATA long distance market until their bottleneck control of local access is eliminated. At this time the RHCs would add nothing to the interLATA market except a demonstrated ability and incentive to use their monopoly position and huge ratepayer-supplied resources to hinder competition and squeeze out the developing OCCs. The public interest demands that the Bell Companies instead refocus their attention and resources on their principal mission—bringing the same kind of lower-cost digital service to local telephone users that NTN and the OCCs are making available to long distance customers.

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[15] RHC profits have reached such an unreasonably high level that groups such as the Consumer Federation of America and International Communications Association, and agencies such as the General Services Administration and Department of Defense, have publicly called for a rollback in rates charged for monopoly local telephone services. In addition, for now at least, the RHCs' competitive ventures are incurring huge losses. The RHCs generally admit that any future profits generated from competitive ventures would not be used to subsidize rates for local service, a fact confirmed by the separate treatment given to the profits of their Yellow Pages operations.

STATEMENT OF THE NORTH AMERICAN TELECOMMUNICATIONS ASSOCIATION

I. GENERAL OBSERVATIONS

It is a tribute to the political resources and influence of the Bell Operating Companies ("BOCs") that "relief" legislation for these companies is being seriously considered. Essentially, the BOCs are asking Congress to nullify the judgment in an antitrust case. This Modified Final Judgment ("MFJ") was not unilaterally imposed on the Bell System, but resulted from an arm's-length settlement agreement that yielded substantial benefits to the BOCs.[1] As a general policy, Congress does not and should not intervene to change the result of a court trial merely to suit the convenience of some parties. Such tampering not only raises issues regarding separation of powers, but it opens the door to a parade of supplicants seeking similar relief.

Even more amazing, the BOCs are asking for mfj relief without any showing of special need. These are not bankruptcy-threatened remnants of a dying industry. To the contrary, since divestiture the BOCs have enjoyed a highly favorable regulatory climate and continually increasing traffic on their local networks. As a result, they are enjoying virtually unprecedented prosperity while competitive companies watch their profit margins shrink. BOC profit margins in 1985 increased by 11%, while profits for U.S. industry declined by 11%.

This Committee should not be drafting relief measures for companies that deserve no special consideration. Instead, this Committee should investigate the post-divestiture performance of these giant monopolists. Are the BOCs providing local exchange service at reasonable rates, as mandated by the Communications Act? Or are they using unprecedented local rate increases to fund a massive diversification campaign and engage in subsidized price wars against their competitors? Available evidence supports the latter inference. The evidence also shows that, faced with the task of restraining seven regionally dominant monopolies, the Federal Communications Commission ("FCC") has largely abdicated its regulatory responsibilities.

This Committee should drop all consideration of measures to confer private benefits on the BOCs at the public's expense. Instead, it should draft and report a bill to (1) require the BOCs to conduct all unregulated activities through fully separate subsidiaries, and (2) require that ratepayers realize a tangible and direct dividend from their funding of the BOCs' diverse competitive activities.

II. THE FORUM FOR ADMINISTERING THE MFJ SHOULD NOT BE CHANGED

There is no compelling reason to strip the District Court of jurisdiction over the MFJ. The court's jurisdiction was conferred by a Federal statute, and no one can credibly claim that the court has neglected its duties, ignored due process, or excluded public participation. The AT&T settlement was approved pursuant to a Tunney Act public interest inquiry of unprecedented size and scope, in which all parties, including numerous regulatory agencies and public interest groups, were pemitted to intervene. The MFJ has been continually reviewed by the Justice Department and the court, even though it has been effective for less than three years. The court has repeatedly and explicitly invited the participation of non-parties in all of its proceedings.

This is not to say that NATA supports all the court's rulings on the MFJ. In fact, the court's rulings have overwhelmingly favored the BOCs. Since January 1984, the court has granted about 70 waivers allowing the BOCs to diversify into competitive businesses (including many businesses from which they had been barred ever since 1956). It has denied only one. Despite these results, however, NATA strongly believes that MFJ review should remain with the court, where it lawfully belongs.

NATA is especially opposed to the wholesale transfer of crucial MFJ review functions to the FCC. Key MFJ issues have been prejudged by the FCC, as evidenced by Commissioners' public statements before Congress and othe forums. Furthermore, the FCC's past record hardly inspires confidence in its ability and willingness to address the antitrust problems of a half-monopoly, half-competitive industry. The MFJ itself was approved because the court recognized, based on the trial record, that the FCC "never has been capable of effective enforcement" of behavioral restraints on the anticompetitive conduct of large regulated monopolies. *United States* v. *American Telephone and Telegraph Co.*, 552 F. Supp. 131, 168 (D.D.C. 1982).

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[1] If, as was likely, the Bell System had been found guilty of antitrust violations, the BOCs would have faced hundreds of millions of dollars in potential treble damage liability in numerious pending private antitrust lawsuits. Instead, the BOCs avoided any final judgment that could be used against them in pending or future cases. As a result, they were able to settle pending private suits for a small fraction of the damages claimed.

In recent years, the FCC's approach to critical issues has increasingly favored ad hoc decisions over reasoned, record-based policymaking. Even on matters that go to the heart of its statutory mandate, such as network access charges and depreciation practices, the Commission has been frequently criticized for hasty decisions that unnecessarily increase local telephone rates. In addition, the FCC has largely abandoned oversight of its *Computer II* structural separation rules, prematurely disbanding its *Computer II* task force and failing to effectively audit BOC cost allocations to competitive subsidiaries. At present, the Commission is moving precipitously to repeal those separation rules, thereby throwing away its most effective ratepayer protection tool at a time when it is understaffed and wholly unprepared to enforce substitute safeguards. If the FCC cannot fulfill its existing statuatory obligations, it should not be entrusted with additional antitrust responsibilities.[2]

III. THE CRITERIA FOR REVIEWING MFJ RESTRICTIONS SHOULD NOT BE WEAKENED

There is no reason for Congress to dilute the exising standard governing modifications of the MFJ. Indeed, the existing standard is dangerously weak. At present, the divestiture court is required to grant waivers of the MFJ restrictions if there is no substantial possibility that a proposed BOC activity would impede competition in relevant markets. Under this standard, the court has granted some 70 MFJ waivers and denied only one. But there is substantial evidence that the BOCs' diversification campaign has harmed ratepayers by diverting company resources from local telephone service. Congress should consider applying an additional test: BOC diversification should be permitted only where it will not impede competition and will not lead to increased telephone rates.

IV. REMOVAL OR DILUTION OF THE CORE MFJ RESTRICTIONS WILL HARM COMPETITION, CONSUMERS, U.S. TRADE, AND LABOR

A. Competitive Impact

The AT&T trial and the Tunney Act settlement proceedings provide ample evidence of the dangers to competitive markets posed by BOC entry into manufacturing, long-distance and information services. Nothing has happened since divestiture to significantly reduce these dangers. The potential impact of MFJ modifications on the customer premises equipment ("CPE") markets in which NATA members participate is described in detail in the attached Comments which NATA has previously submitted to the Justice Department. The main dangers to these markets are as follows:

1. If allowed to manufacture CPE, the BOCs will impose discriminatory technical standards to discourage connection of competing equipment to the network.
2. The BOCs will withhold competitive access to essential technical and market data which will be provided to their own manufacturing divisions.
3. The BOCs will coordinate the timing, price and features of new network services to provide strategic market advantages to their CPE manufacturing arms.
4. The BOCs will use ratepayer funds to subsidize research and development and other functions of its manfuacturing arm, giving the latter an artificial and overwhelming competitive advantage.
5. If also allowed to provide information services, the BOCs will use their monopoly control of local networks to even greater advantage in CPE markets. The BOCs' main interest in information services is to enhance their Centrex offerings to business customers. (Centrex is a network service which competes with PBXs and other business CPE, and which is currently supported by discriminatory rate structures.) The BOCs would provide their Centrex customers with preferential access to information services incorporated in the network, while providing inferior interconnection at higher rates to customers using premises-based systems.

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[3] Implementation of the MFJ by the FCC would also require an explicit or implicit modification of the current statutory limitations (47 U.S.C. S. 152(b)) on FCC jurisdiction over intrastate service. For example, Section 4(c)(1) of S. 2565 (introduced by Senator Robert Dole, R.-Kan., June 18, 1986) requires the BOCs to file exchange access tariffs at the FCC for "interexchange telecommunications," without distinction between interstate and intrastate interexchange service. Such jurisdictional changes would be essential to actually achieve the consolidation of policy responsibilities claimed by the proponents of S. 2565.

These competitive dangers will persist as long as the BOCs unilaterally control access to and use of their bottleneck exchange network facilities, which are the only realistic local transmission alternative for the vast majority of U.S. consumers.

B. Availability and Price of Telecommunications Products and Services

The AT&T breakup opened major new markets to competition, reducing prices and promoting innovation. The MFJ restrictions ensure that telecommunications markets remain open to competitive innovation, permitting customers to choose from a wide variety of products and services.[3] Removal of the MFJ restrictions would suddenly reverse that trend, signalling to the industry that newly competitive markets will once again be closed to competition—causing industry turmoil, chilling innovation and ultimately raising prices in all markets.

In addition, removal of the MFJ restrictions would cause further increases in local telephone rates. The BOCs have already taken advantage of post-breakup confusion to raise local rates to unconscionable levels. In 1984-85, local exchange rates were increased by well over $5 billion. The BOCs used these excess profits to fund a diversification binge into numerous competitive ventures, which incurred estimated losses of almost $1 billion in 1985 alone. BOC entry into long-distance, information services, and equipment manufacturing would trigger yet another round of local rate hikes to capitalize and subsidize these enormously expensive ventures. The BOCs have stated they will not return their profits, if any, from competitive businesses as a "contribution" to local service rates.

C. Implications for Trade and Labor

Improving U.S. telecommunications exports requires a healthy and competitive domestic equipment industry. Historically, the monopoly telephone industry did not export; independent manufacturers do export. Returning domestic markets to a captive monopoly condition will cripple the United States' ability to export by depriving independent U.S. manufacturers of their domestic market share. This in turn will cause loss of jobs in the United States.

Moreover, the BOCs are unlikely to start new manufacturing ventures from scratch, but will acquire existing companies. Thus, the BOCs' entry will not increase the number of competitors in either domestic or export markets. Instead, BOC manufacturing acquisitions will reduce competition through subsidized price cutting and discriminatory equipment standards.

V. ALTERNATIVE APPROACHES AND SAFEGUARDS

With respect to the "core" MFJ restrictions regarding long-distance, information services and manufacturing, there is no compelling need for Congressional action. Furthermore, as discussed above, precipitous Congressional intervention in these aspects of the Decree would have grave consequences. The present dangers to ratepayers and competition from BOC entry in these markets cannot be adequately contained by measures short of the MFJ prohibitions.

It is possible that certain other MFJ-related functions could be more effectively performed by the FCC. This question, however, should be fully explored at hearings before any action is taken by the Committee. And under no circumstances should the measures adopted by the Committee overturn or transfer jurisdiction over the MFJ's core line-of-business restrictions.

To the extent that the Committee considers it necessary to address those core restrictions, it should employ measures narrowly targeted to address identifiable problems and carefully conditioned to minimize anticompetitive effects. Regarding the manufacturing restriction, for example, the BOCs have argued that they cannot always obtain the network products they need from outside manufacturers, because the latter are sometimes unable or unwilling to devote R&D resources to the development of products with limited commercial applications.[4] The BOCs also complain that dealing with outside manufacturers for their network needs forces them to give away valuable market and technical information to their competitors.[5]

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[3] Some advocates of BOC "relief" claim that the MFJ restrictions are turning local networks into "stagnant technological backwaters." This is nonsense. The BOCs themselves claim to be spending as much as $2 billion each in 1986 to improve their networks, and manufacturers are competing fiercely today to sell state-of-the-art products to this lucrative market. Even in the capital- and research-intensive digital switch market, there are at least eight manufacuters seeking procurement contracts from the BOCs.

[4] Chairman William Weiss of Ameritech has stated he merely wants the freedom "to develop something that would be useful . . . where my commitment of some capital would enhance the manufacturer's willingness to do the job for me. Or, I might want to make a widget that is useful and that nobody else wants to make, but is important to be just to be able to give full service." *Telephone,* February 3, 1986 at 56.

NATA is skeptical of these claims, and urges the Committee to fully investigate them before taking any action. Assuming that these claims have merit, however, the Committee can address them without overturning the MFJ manufacturing restriction. For example, the Committee could draft legislation to permit BOC participation in a research and development consortium of carriers and equipment manufacturers which would carry out joint research and development on improvements to the telephone network. A system of royalties paid to the consortium would ensure that the BOCs and their ratepayers benefitted from any non-network commercial applications of jointly funded research. At the same time, manufacturers would be assured of their right to use the fruits of the research and to avoid discriminatory network applications.

Any bill drafted by the Committee should include strict conditions to minimize the impact on ratepayers and competitive markets. One essential safeguard is to require fully separate subsidiaries for any unregulated activity in which the BOCs are involved. The weak separation requirements approved by Judge Greene are inadequate to prevent cross-subsidization and excessive diversion of capital to unregulated businesses at the expense of regulated ratepayers. Even worse, the FCC has precipitously acted to dismantle the stronger separation requirements which have been applied to the BOCs' provision of CPE and enhanced services. To prevent further erosion of these essential constraints on monopoly behavior, Congress should amend the Communications Act to ensure that fully separate subsidiaries are required for any unregulated product or service offered by a BOC or other telephone utility of comparable size and market power. The Committee could use as its starting point the separation requirements approved by the Senate in S. 898.

A second crucial condition is a ratepayer dividend or royalty on unregulated activities. The Committee should seek to guarantee that any measures taken will benefit ratepayers—not just the BOCs themselves. This can be most directly accomplished by requiring that a percentage of any profits from a BOC's competitive ventures be credited to the BOC's revenue requirement for local exchange service.

A third condition, which should apply to any BOC manufacturing activity, is a minimum requirement for BOC equipment procurement from and sales to independent firms. Such requirements provide an essential market test to ensure that internal transactions between the BOCs and their manufacturing affiliates take place at nondiscriminatory, market-based prices which are not inflated to the detriment of ratepayers. Similar independent market tests were required in Sections 230 and 239 of S. 898.

Finally, if the BOCs are allowed to compete in unregulated markets, then they must be required to reciprocate by opening their local exchange monopolies to competition. At present, local service competition is limited primarily to services which completely "bypass" the local network, and which attract only a narrowly limited class of users with highly specialized transmission needs. Real competition in this market will require the BOCs to relinquish their exclusive control of "bottleneck" facilities which provide the only ubiquitous local service option for the vast majority of telecommunications users.

If this Committee chooses to "free the BOCs," it must also "free the local exchange" from the tyranny of tariff restraints imposed by monopoly carriers. The exchange "bottleneck" must become a neutral, open highway which customers and service providers can use as they see fit, without being limited to the narrow and discriminatory service configurations of BOC-controlled tariffs. For example, the features provided in Centrex service must be fully unbundled so that customers are not required to buy the whole package to get the functions they want at a reasonable price. To achieve true reciprocity between the BOCs and their competitors, vague promises of "open architecture" are not enough. At a minimum, Congress must mandate unrestricted resale of local service, cost-based unbundling of local tariff elements, and nondiscriminatory access to software-controlled switching features.

CONCLUSION

It would be a serious mistake for this Committee to begin from the premise that the BOCs need or deserve some form of MFJ relief. Instead, this Committee should inquire whether ratepayers have benefitted while the BOCs pursue their increasingly diverse competitive interests, and whether the FCC is effectively overseeing these seven giant telephone monopolies. In NATA's view, the results of the Committee's inquiry will demonstrate that what is needed is better oversight, not further dilution or nullification of the MFJ. If the Committee arrives at a different result, however, it must at least exact reciprocal guarantees. Any legislation to chagne the AT&T settlement in the BOCs' favor must include strong conditions to protect ratepayers, minimize competitive harm, and ensure that the local exchange itself evolves toward effective competition.

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[5] *See* testimony by Robert A. Dickemper, Vice President, Southwestern Bell Corporation, before the House of Representatives Subcommittee on Telecommunications, Consumer Protection and Finance (March 13, 1986).

STATEMENT OF NYNEX CORPORATION

INTRODUCTION

NYNEX Corporation believes that the bill introduced by Senator Dole, S. 2565, the Federal Telecommunications Policy Act of 1986, is an important and appropriate measure. It will consolidate in the Federal Communications Commission day-today implementation of the nation's telecommunications policy at the federal level. Consumer benefits from free and open competition can best be balanced with the need to preserve universally available and affordable local telephone service in this way.

NYNEX believes that S. 2565 is correct and complete as introduced. It places the responsibility for the AT&T and GTE consent decrees with the FCC and, thereby, will contribute to the development and implementation of a more cohesive national telecommunications policy. The transfer of administration of the Modification of Final Judgment (MFJ) and the GTE consent decree to the agency created by Congress for telecommunications regulation will allow for all public policy concerns, not just anti-trust concerns, to be taken into account. At the same time, it will not detract from the authority of the Department of Justice, which will continue to enforce antitrust law, nor will it impede any other agency from meeting its responsibility to address telecommunications policy.

COMMITTEE FINDINGS

NYNEX fully supports the Senate Commerce Comittee's findings that access to, and usage of, the local telephone network must be universally available at fair and reasonable rates; that the primary telecommunications objective of the FCC should be to preserve the universal availability of affordable telephone service; and that whenever possible, competition should be substituted for regulation.

NYNEX has been and continues to be committed to universally available and reasonably priced telephone service. Universal service is a goal that essentially has been achieved and should be maintained. This commitment to maintaining universal service has been repeatedly expressed by NYNEX officers and is summarized by the following remarks made by NYNEX's Vice Chairman and Chief Financial Officer, William G. Burns, at the School of Business of the University of Vermont on September 25, 1985.

"Universal service is not only a traditional, moral imperative for us, it also makes good business sense. As we said in our filing to the National Telecommunications and Information Administration of the United States Department of Commerce: 'NYNEX is committed to maintaining universal service, and needs no incentives or regulatory oversight to do so. Our future depends on it.' The heart of our business is the local network—and what makes that network so valuable is the fact that it is universal."

We also pride ourselves on our ability to provide local telephone service with the same high quality that was traditionally the standard before divestiture. Indeed, we believe that it is the local telephone companies which set the example for all in determining excellence in providing telephone services. That NYNEX provides a high standard of service should not be surprising. The post-divestiture era of competition has only served to increase the incentive to maintain high quality service at reasonable prices. Competition provides a very effective form of regulation. It is competition that promotes economic efficiency and maximizes consumer welfare and benefit.

TRANSFER OF CONSENT DECREE(S) AUTHORITY

The transfer of jurisdiction over the AT&T and GTE consent decrees to the Federal Communications Commission has raised several concerns, many of which are procedural in nature. NYNEX believes that these are already being met by existing practice.

The FCC was created by Congress through the Communications Act of 1934. In Title 1—Section 1 of the Act, the Congress spelled out broad policy concerns that should guide the FCC. It states: "For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is hereby created a commission to be known as the "Federal Communications Commission," which...shall execute and enforce the provisions of this Act."

The Dole bill, as filed, changes none of that. The purpose and the mission of the Commission remains unchanged. There is no basis to believe the Commission will not continue to carry out its statutory responsibilities in the future. In contrast to the Court and the Antitrust Division of the Department of Justice, the FCC has adequate personnel and technical expertise to deal with all aspects of telecommunications regulation, and to fulfill the Congressional mandate.

Over the years, the FCC has developed broad expertise in the regulation of the nation's telecommunications industry. This experience would be invaluable in resolving consent decree issues. Furthermore, the FCC has a public interest mandate which requires careful consideration of any decision it makes in the light of its impact on telephone rates and services. Although the Court and the Antitrust Division of the Department of Justice have dutifully fulfilled their obligations to enforce the consent decrees, they have concentrated this activity on antitrust issues. The additional public interest issues of affordable local telephone access and usage, the promotion of U.S. trade benefits and empolyment, and the implications for national security, would be best dealt with by the FCC, under its public interest determination standard.[1]

Furthermore, the FCC is directly accountable to the Congress. There should be no doubt that the Congress would use its power to correct the FCC if it thought the agency acted inappropriately.

AGENCY PARTICIPATION

Several executive branch agencies currently have certain authority and responsibilities or charters which impact on telecommunications policy. These agencies have used their authority to participate in the development of this policy when it has been appropriate to do so. There is no reason to believe that they would not continue to do so in the future. For example, the Secretary of Commerce has the responsibility to "conduct studies and make recommendations concerning the impact of the convergence of computer and communications technology," and to conduct "economic and technical analyses of telecommunications policies, activities and opportunities." [Executive Order 12046, March 17, 1978]. It was in response to this obligation that the National Telecommunications and Information Administration (NTIA) prepared its July 1985 Special Publication entitled "Issues in Telecommunications: Directions for National Policy."

In response to a request from Congress on the effects of the FCC's regulatory decisions on telephone service, particularly in regard to rural areas, the U.S. General Accounting Office (GAO) evaluated the issue and summarized its findings in the report entitled "The FCC's Monitoring of Residence Telephone Service", June 1986.

Several agencies have issued statements in favor of S. 2565. These statements do not reflect a fear of losing and, of course, these agencies will not lose authority they presently hold. In his testimony before this committee, concerning S. 2565, Assistant Attorney General, Douglas H. Ginsburg, stated "..it is imperative that the present dual regulatory system be restored to a unitary system based on the expert agency—the Commission—that can best ensure that the regulatory regimes embodied in the decrees are implemented in a manner consistent with other telecommunications-related regulations. It is time for the Department of Justice to return to its traditional role of investigating and prosecuting federal antitrust violations." Alfred C. Sikes, Assistant Secretary for Communications and Information, stated in a news release, "The Dole Bill does not prejudice positions parties have taken, nor prejudge the resolution of issues raised by the AT&T decree. Those issues will be weighed by the expert admistrative agency in open rulemakings. The Administration and others with a stake in the sound resolution of those issues will have an opportunity to participate fully."

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[1] The Commission, by the authority given to it by the Act, "may conduct its proceedings in such manner as will best conduce to the proper dispatch of business and to the ends of justice. . . ." [Communications Act of 1934, Section 4 (J)]. If an MFJ-related waiver request or other inquiry were to raise questions in need of investigation, the FCC would presumably follow its published rules and procedures. Any party to an FCC proceeding has the right to file comments; there is no reason to expect any different procedure in MFJ-related proceedings.

These agencies, as well as other interested parties, will certainly continue to participate and will have the opportunity to be significant partners in the development of telecommunications policy, and no separate statutory directive is required.

SAFEGUARDS

Assurance that ratepayers are not unfairly burdened and/or that competitors are not discriminated against, is currently addressed by regulation at both the state and federal level. These regulations have developed a number of safeguards which protect the telephone ratepayer from bearing the burden of any startup costs or losses that new ventures may experience.

Separate subsidiaries hve been established in the past to ensure that safeguards against cross-subsidization for new lines of business exist. That is the first of four standard waiver conditions established by the Court in July, 1984. Both the FCC and state utility boards have the power—and they directly exercise that power very diligently—to review and approve any agreements or cost allocations between the regulated and unregulated activities. In addition, the current Court conditions provide that the subsidiary must obtain debt financing on its own credit. This insulates telephone company stock and assets from creditors. The total estimated net revenues from all such businesses must not exceed 10% of the regional company's total estimated net revenues, and the monitoring and visitorial provisions of the MFJ apply to all such businesses. The Court's four conditions are comprehensive and were designed to prevent "distraction" from other MFJ-mandated activities and to protect both the ratepayer and competition. To the extent those conditions serve the public interest, they will continue to be effective in accomplishing their purpose in the future under the direction of the FCC, which, for example, introduced the separate subsidiary concept in its Computer I and Computer II proceedings, long before that approach was adopted by the Court. As a further continuing safeguard, the regional companies remain subject to state and federal antitrust laws and other applicable commercial laws and regulations. In most cases, these can be enforced not only by the DOJ or state prosecutors, but also by private parties.

In the federal regulatory arena, the FCC has recognized that separate accounting mechanisms in appropriate cases are another effective means of ensuring that regulated services do not cross-subsidize the provision of unregulated enhanced services. The Commission, in its recent CI-III (CC Docket No. 85-229) Order, decided that the use of separate accounting, rather than the existing structural separation was in the public interest. In its decision, the FCC found that the costs to the public in requiring the divested telephone companies to provide enhanced services on a separated basis outweighed the public benefit. The FCC's order further provided that the telephone operating companies must implement approved Open Network Architecture Plans, to be filed by February 1, 1988, that satisfy comparably efficient interconnection requirements and additional unbundling requirements, that they must file cost identification and accounting manuals that comply with the rules to be established in the Joint and Common Cost proceeding, known as Part X, and that they must adhere to protective requirements limiting the use of customer proprietary network information.

The FCC has also initiated a review of its Part X Rules and Regulations (CC Docket No. 86-111). This review will provide an improved basis for identifying joint and common costs incurred by regulated entities on behalf of the non-regulated entities. It will also apportion the joint and common costs between the regulated and non-regulated entities and activities, as well as establish the accounting guidelines to be followed in the identification and apportionment process for the telecommunications industry. The ultimate goal of this proceeding is to ensure that ratepayers pay just and reasonable rates by protecting them from cross subsidization of non-regulated ventures by regulated services.

Today, the use of both structural separation and accounting separations is allowed as determined by the Court and/or regulators to ensure that cross subsidization does not occur. It has been demonstrated that either method can protect the ratepayer. On an individual case basis, it may be determined which of the two methods would provide the most efficient and economical means of offering products and services while protecting the basic ratepayer and competition.

Given the present level of regulatory scrutiny and the existing safeguards at both the federal and state levels, and the fact that the NYNEX remains subject to the antitrust laws and many other commercial laws and regulations, there is simply no significant likelihood for us to cross-subsidize competitive ventures with regulated activities. This is especially true, given the dynamics of the marketplace and the aforementioned regulatory scrutiny under which we operate. Accordingly, any proposals for amendments associated with additional safeguards are not needed and would, in fact, impede the ability of the FCC to fashion safeguards appropriate to a variety of circumstances.

PETITION FOR WAIVERS

The MFJ's line of business restrictions were predicated on an assumed post-divestiture status of the Regional Companies' telephone subsidiaries as regulated monopoly providers of local exchange service. With their control of exchange facilities, it was believed that they would then have both the incentive and the ability to thwart competition in unregulated lines of business by leveraging their monopoly power from the exchange telecommunications market. In the absence of the restrictions, the regional companies were thought—erroneously—to be capable of; (1) subsidizing their prices in competitive markets from profits earned in their monopoly market; and (2) hindering competitors by restricting their access to the local network.

Today, NYNEX and the other regional companies are allowed to request a waiver from the line of business restrictions of the AT&T Consent Decree. Permission to enter a new line of business is permitted only when the petitioning company can prove that the standard established by the Court has been satisfied. Under Section VIII(C) of the MFJ, "the burden is on the petitioning Regional Holding Company ... [to] ...demonstrate that it could not use its local telecommunications monopoly to obtain an unfair competitive advantage in a new market through cross subsidization or other anticompetitive behavior."

This waiver procedure under the MFJ has been used extensively by the regional companies. The result is the Department of Justice and the Court are now involved in heavy regulation of the telecommunications industry. NYNEX believes that the current situation of duplicative, sometimes conflicting, federal regulation was not the intent of the consent decree. NYNEX believes the FCC is the best agency to handle these requests and that no additional safeguards and conditions are required in the way of amendments to the Dole bill.

Because of its authority, the FCC will be able to weigh additional public interest factors against perceived potential risks of entry by the regional companies into these markets. This is a weighing not adequately done in the current process. In addition, with the use of its standard procedures, the FCC will be able to process these waiver requests more expeditiously than is done today.

CONCLUSION

In summary, the NYNEX Corporation supports S. 2565, as introduced. We believe it appropriate to transfer the supervision of the AT&T and GTE consent decrees to the FCC in order to integrate these consent decrees into a national telecommunications policy. We believe that the FCC is the proper place for this authority because of its expertise and ability to determine appropriate policy based on broad range of issues.

NYNEX believes that S. 2565, as proposed, is adequate to transfer authority over the consent decrees to the FCC. NYNEX strongly believes that the Commission can accomplish Congress's public interest objectives within the Commission's current Communications Act responsibilities.

STATEMENT OF PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA

The Service Commission of the District of Columbia (D.C. PSC) opposes S. 2565 "The Federal Telecommunications Policy Act of 1986" (the Bill) because it will limit the D.C. PSC's authority to regulate the activities of The Chesapeake and Potomac Telephone Company (C&P), possibly to the detriment of the ratepayers of the District of Columbia. C&P is the local exchange carrier in the district of Columbia. The D.C. PSC is the administrative agency established by the Congress of the Unites

States of America to regulate public utilities operating within the District of Columbia, including C&P.

The stated purpose of the Bill is to consolidate in the Federal Communications Commission (FCC) all federal telecommunications policy, including the AT&T and GTE consent decrees, which have been in effect since 1982. This would be accomplished by shifting the responsibility for administering, enforcing and modifying the AT&T and GTE consent decrees from the U.S. District Court for the District of Columbia to the FCC.

In the memorandum accompanying the Bill, Senator Dole states that the Bill is not an amendment to the Communications Act of 1934 (the Act). This would imply that the Bill would not affect the dual system of Federal and State regulation established in the Act, whereby the FCC has authority over interstate and foreign communications and the state commissions have authority over intrastate communications. However, Senator Dole goes on to state that the limitations placed on the FCC's jurisdiction under Section 152(b) of the Act would not apply to the FCC's jurisdiction under the Bill. Section 152(b) of the Act is the provision which reserves jurisdiction over intrastate communications to the states. Thus, in effect, the Bill would limit the D.C. PSC's authority to regulate C&P. The D.C. PSC opposes the Bill, and any other legislation, that would limit its authority to regulate C&P and that would exempt the FCC from the limitations placed on its jurisdiction by the Act.

The D.C. PSC is of the view that any such shift in jurisdictional authority is contrary to the public interest and the goal of universal service. The states must retain the authority to regulate intrastate services in order to safeguard the ratepayers from any adverse effects of a relaxation of the consent decree provisions and diversification of the Bell Operating Companies. If the states do not retain complete authority to regulate intrastate services, they will not be able to effectively control rates for local service. Since universal service is primarily a function of local rates, the states would not be able to ensure universal service.

The FCC could not effectively replace the states in performing this function. The FCC evaluates and establishes communications policy on a national level. It has neither the time, nor the resources, nor the familiarity with peculiar local needs to be able to consider all of the circumstances unique to a specific jurisdiction and to establish separate policies for each jurisdiction. This shortcoming would not be corrected by requiring the FCC to consult with other federal agencies before modifying the consent decrees inasmuch as these agencies also operate on a national level.

The D.C. PSC is of the view that at the least any legislation must clearly state that there will be no jurisdictional shifts in authority between the FCC and the states. The jurisdictional effects of the Bill cannot be left to an "unspoken understanding" that the FCC will not adversely infringe on the states authority to regulate intrastate communications services. The FCC has too often in the recent past tried to preempt the states' authority to regulate intrastate communications in a number of areas including depreciation rats, public land mobile services, two-way intrastate telecommunication services provided by cable television companies and intrastate common carrier paging provided over FM subcarrier frequencies. These actions have resulted incostly and lengthy litigation before the courts, as in *Louisianna Public Service Commission* v. *FCC*, 90 L. Ed. 2d 369 (1986). They also demonstrate that the FCC is not always inclined to consider the states' views when they conflict with the FCC's policies.

The dual system of Federal and State regulation, where the states have the sole authority to establish intrastate rates, has gone far in promoting universal service to date. To ensure that the goal of universal service continues to be met, the balance of authority between the FCC and the states, established in the Communications Act, must be maintained. Since the Bill would shift some state jurisdictional matters to the FCC, the D.C. PSC must oppose the Bill, and strongly urges this Committee to do the same.

STATEMENT OF ROBERT D. ROSS, PRESIDENT, CALL-IT CO.

Call-It Co. is a division of Lee Enterprises, Incorporated. Lee is a multi-media company that is an innovator in newspaper automation. It publishes sixteen daily newspapers in seven midwestern states and owns six broadcast stations. In 1983, through Call-It Co., Lee joined with Audichron, a supplier of information service equipment to the Bell System, to conduct market experiments in various forms of electronic publishing. Since then, Call-It Co. has been engaged in offering audiotext information services using local telephone lines.

Call-It Co. has used a voice-storage device, a computer incorporating a sophisticated software program, to furnish two types of audiotext servies. The first involved the use of the Bell Operating Companies' (BOCs) new mass announcement ("976" or "Dial-It") local exchange services to provide audio programs. These programs ranged from children's adventure stories to time, weather, sports scores, horoscopes and other types of information that consumers accessed by telephone. The second type of audiotext service is a telemarketing service that permits consumers to order products and services by telephone over AT&T's 800 network and the associated access services furnished by the BOCs.

Call-It Co.'s interest in these hearings stems from its perspective as an independent information services provider (IP) which has dealt extensively with the BOCs. Call-It Co. has become intimately familiar with the web of dependencies that tie IPs to the BOCs and with the significant potential that the BOCs have for engaging in anti-competitive conduct if they are permitted to furnish information services in competition with the BOCs.

I will show that there are no existing mechanisms that are sufficient to prevent the BOCs from engaging in anti-competitive practices. The types of prophylactic measures that the BOCs contend will prevent anti-competitive conduct have not even been formulated by the Federal Communications Commission (FCC), much less implemented and tested. Yet Chairman Mark Fowler and other Commissioners have already decided to allow the BOCs to immediately furnish information services if Congress transfers authority over the AT&T Consent Decree to the FCC, subject to safeguards that they have no way of knowing will be effective.

THE BELL OPERATING COMPANIES AND AT&T CONTINUE TO CONTROL ESSENTIAL TELECOMMUNICATIONS FACILITIES

After an exhaustive expenditure of resources in the largest antitrust case ever litigated, with the recommendation of the Department of Justice, the Courts approved the AT&T Consent Decree which prohibits the BOCs from providing information services and AT&T from engaging in electronic publishing. The Decree became effective less than three years ago. In view of the extensive consideration given to the need for the restrictions, the BOCs and AT&T have a large burden to show that circumstances have so drastically changed in such a short period of time that the restrictions should be now eliminated. However, they have provided absolutely no probative evidence to Judge Greene, the FCC or the Congress that their control over the local exchange bottleneck has materially changed in any respect as far as residential and small business customers—the users of information services—are concerned. Information service providers and their customers have and will continue to have no alternatives to the local exchange services of the BOCs.

Bypass facilities are not technically or economically designed to reach the mass audiences to which information services cater. They are essentially point-to-point, rather than multipoint-to-point, transmission devices that typically are so prohibitively expensive that only a handful of large communications users can justify them for very limited purposes. Other alternative facilities, in particular cable television, are poor substitutes for the local exchange. They do not have the right architecture and they also do not reach mass audiences.

Furthermore, the BOCs, with the encouragement of the FCC, are implementing pricing schemes to deter users from employing bypass facilities. They are also developing alternative transmission techniques, such as Pacific Bell's "Project Victoria", to ensure that the local loop remains the only means of access for voice and data communications for the great majority of citizens.

It is simply irrefutable that the BOCs currently enjoy and will continue to possess monopoly control over the local exchange facilities used to provide information services. Until the BOCs' monopoly power no longer exists, the basic predicate for altering the carefully crafted and considered Decree cannot be challenged.

The determination of the extent to which monopoly power exists and is susceptible to abuse is typically a matter that is addressed by the courts. The Decree Court, under Judge Greene, has developed a considerable body of expertise the antitrust issues raised by the BOCs and AT&T engaging in information services and electronic publishing. The Decree Court should be permitted to address those issues that would be rather than the FCC, which is not an expert agency in the enforcement of the antitrust laws and which has prejudged their resolution.

The Department of Justice is actively reviewing the basis for the restrictions and in barely four months will present its recommendations to Judge Greene on whether the Decree should be modified. Its initial effort, under the auspices of Dr. Peter Huber, is a review of the basic question whether the market conditions that necessitated the information service restrictions have changed. In view of the enormous consequences of a misjudgment, the wisest course for the Senate would be to wait to consider the recommendations of the federal agency responsible for enforcing the antitrust laws and the reaction of the Court responsible for administering the Decree.

THERE ARE NO SAFEGUARDS THAT COULD PREVENT THE TELEPHONE COMPANIES FROM ENGAGING IN ANTICOMPETITIVE CONDUCT

The BOCs contention that there are prophylactic measures which can prevent the misuse of their monopoly power is incorrect. These measures are supposed to assure that IPs receive equal access to the local exchange relative to the access the BOCs provide to their own information services and that the BOCs do not cross-subsidize the prices of their information services with monopoly service revenues. Formulating effective safeguards is a formidable undertaking. A brief review of the potential anti-competitive abuses the FCC would have to deter indicates that no safeguards are likely to be effective at the present time.

If the BOCs are allowed to integrate their own information services into their local exchange networks, it will be very difficult for IPs ever to determine whether they are receiving equal access. Although the interface to IPs would be external and visible, the interface between the network and the BOCs' own information services will reside within the local exchange switches, hidden from inspection. The BOCs will have myriad and probably irresistable opportunities to discriminate in favor of their own information services in terms of the type, quality, performance, pricing and other features of the interconnection arrangements.

The FCC has directed the BOCs to develop open network architecture (ONA) plans that they must file, for the Commission's review and approval, by February 1988, in order to provide enhanced services without structural separation. The ONA schemes are supposed to afford competing suppliers of enhanced, and presumably information, services with equal access to the local exchange. The BOCs are exploring a number of ONA schemes but, as many of them acknowledge, they will not be able to introduce these technologies until the 1990s on any widescale basis.

The hazards of allowing the BOCs to engage in information services before their competitors are afforded genuine equal access on technical and pricing terms are palpable and predictable. No demand by the FCC to the BOCs that they must provide equal access would be fruitful if the technology is not available to carry out the obligation. Moreover, since the FCC will not even know what plans the BOCs have in mind until February, 1988, it cannot know at this time whether those plans would provide workable equal access. Until the ONA schemes are designed, implemented and tested, no one will be able to determine whether they will indeed assure equal access.

It is clear, however, that currently, in the absence of effective open network architectures, IPs cannot obtain equal access. The Comparably Efficient Interconnection (CEI) policy the FCC adopted in *Computer III* will provide information providers with something considerably short of equal access. It is also highly questionable whether the BOCs will even develop CEI plans when they will be superseded by the ONA schemes that the BOCs will be simultaneously designing.

The unavailability at the present time of equal access safeguards is paralleled by the lack of accounting controls to guarantee that the BOCs do not cross-subsidize the prices of their own information services. The FCC has been trying to devise a fair method for allocating common costs for more than fifteen years and, by its own admission, it has failed. The FCC is now engaged in yet another effort to develop appropriate accounting tools. It is very problematic whether this latest attempt will be any more productive than the previous ones.

To demonstrate the enormously complex task presented in seeking to prevent cross-subsidization, I have attached to this testimony a monograph (Exhibit A)[1] prepared by the economic consulting firm of Cornell, Pelcovits & Brenner, which has studied public utility cost accounting at the FCC and in the states for a number of years. Their study demonstrates, if the past is prologue, that it is impossible to prevent the BOCs from engaging in widespread cross-subsidization. Every type of allocative mechanism has been tried and found wanting. Both the FCC and the states have been powerless to prevent these abuses through accounting controls.

The BOCs continue to cross-subsidize new services with monopoly exchange service revenues provided by residential consumers. This was recently confirmed by the National Association of Regulatory Utility Commissioners (NARUC). In a study released on September 18, 1986, NARUC concluded that "[a]udit findings have, in fact, revealed that monies paid in rates by local telephone customers have been improperly subsidizing the not yet profitable, unregulated activities of a number of other regional holding company subsidiaries."

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[1] The exhibit was not reproducible.

Conceivably, the FCC's latest effort to develop effective accounting tools will succeed, but one cannot know at this juncture, much less can there be any confidence that they would be relevant to information services. Moreover, unless the states also develop workable accounting tools, there is a significant likelihood that the BOCs would cross-subsidize the bulk of their information services, which for the most part would be offered on an intrastate basis.

The problems confronting information service providers at the present time in their dealings with the BOCs would seem trivial if the BOCs were permitted to offer information services. Call-It Co. has recently withdrawn from the passive audiotext market, which is served by means of the BOCs' "976" tariffs, in part because of disenchantment with the onerous conditions in those tariffs. In many local exchanges, the percentage of revenue generated by Call-It Co. that the BOCs demanded was too high and in other exchanges sufficient 976 facilities were not available. Call-It Co. was also stymied by the checkerboard pattern of differing rates and restrictions among BOCs.

In view of these difficulties and Call-It Co.'s assessment that the interactive audiotext service market offered more promise, Call-It Co. decided to direct its efforts in the latter direction. It is implementing its plans for entering the interactive audiotext market and it is currently providing telemarketing services.

Call-It Co.'s experience with the telemarketing service industry illustrates the severe problems that would be presented by BOC entry into information services. Any BOC central office switch that is electronic can be programmed to offer the same telemarketing services that Call-It Co. is providing. If the BOCs are permitted to incrementally price those services, with most of the common costs for the switch, building, personnel and administration paid for by the consumer using monopoly services, there is simply no way that Call-It Co. could compete.

A second intractable problem with the BOC provision of telemarketing services would be their inevitable involvement in information creation and manipulation. Call-It Co. not only programs its voice storage system, it works with the magazine publisher to write and edit the scripts. In a dynamic on-line environment, where questions are being constantly revised, there is no way that the BOCs could avoid becoming enmeshed in the content of information were they to enter the telemarketing business.

If the FCC allows the BOCs into information services and AT&T into electronic publishing, the public will suffer not only from the loss of competition that would result but also because their monopoly customers would cross-subsidize their new ventures, as the recent NARUC study and other findings demonstrate.

In 1985, the BOCs lost almost one billion dollars in their unregulated businesses. These losses were funded by monopoly ratepayers. Notably, since divestiture, local telephone rates have increased considerably more than the Consumer Price Index. In this time span, the CPI has increased 9.5 percent but rates for urban customers have increased by 22.7 percent and rates for rural customers by 35.3 percent, without taking into account the FCC's access charge fees.

The basic obligaton of the BOCs should be to provide quality telephone service at affordable rates to the public. It is entirely probable that if the BOCs and AT&T were permitted to engage in information services and electronic publishing, it would be at the expense of the basic obligation. Certainly, the BOCs have never demonstrated that if they were permitted to offer information services, they would be able to provide basic telephone service at more affordable rates.

THE DIVERSITY PRINCIPLE SHOULD BE AFFIRMED

The intrusion of the BOCs and AT&T into the collection and development of information would violate the Diversity Principle, which is a cornerstone of the AT&T Consent Decree. The Diversity Principle provides that telephone companies which have monopoly power over vital telecommunications facilities should not be allowed to also control the information carried over those facilities to compete with information providers who must use their facilities.

If the Diversity Principle were eliminated, the telephone companies would have enormous anti-competitive advantages. They would be able to engage in discriminatory interconnection and cross-subsidization practices and would enjoy an immeasurably superior marketplace position. By virtue of supplying essential telecommunications facilities, the telephone companies acquire significant information about their competitors' collective and individual marketing strategies, technology, customer base and pricing schemes. This gives the telephone companies an immense competitive edge that they would use to their benefit in designing and marketing their own information services. Clearly, there are significant anti-competitive dangers presented by the prospect by the telephone companies entering the information services and electronic publishing fields.

In light of these dangers, coupled with the burden that their entry would place on their monopoly ratepayers, the Senate should not transfer the authority to modify the Decree to the FCC, given its determination to remove the restrictions on the BOCs and AT&T. If the Senate is inclined to make this transfer of authority, it should uphold the Diversity Principle by directing the FCC to bar the BOCs from providing information services and AT&T from engaging in electronic publishing until they no longer enjoy monopolistic and entrenched positions in the telecommunications marketplace.

STATEMENT OF STEPHEN L. SKIPPER

DEREGULATION OF THE TELECOMMUNICATIONS INDUSTRY: WHY AND HOW

Traditional Utility Regulation

Early in the twentieth century federal and state governments began to regulate the telecommunications industry for the purpose of promoting (1) economic efficiency and (2) universal service. The government recognized a need to encourage research and development, to encourage the extension of the telephone network to as many people as possible, and to design rates to ensure maximum social satisfaction and market penetration. As a method of achieving these goals, privately owned telephone companies were allowed to develop monopoly power. Utility regulators and the regulated utilities have used monopoly profits to subsidize unprofitable construction projects and to subsidize the prices of various classes of service.

As a condition of allowing the monopolization of the telecommunications industry, the government imposed comprehensive price and service regulation to prevent telephone companies from realizing excessive monopoly profits.[1]

Deficiencies of Utility Regulation

The ability of regulators to prevent telephone companies from earning excessive profits has been frustrated by a lack of comprehensive regulatory authority and the imposition of judicial interpretations of Constitutional due process. Traditionally, utility regulators do not have the authority to control the corporate structure of regulated utilities[2] and are not allowed to interfere in the management of such businesses.[3]

The practical effect of these deficiencies is that utility regulators cannot effectively control the price of services received from unregulated divisions and affiliates. For example, the level of payment for goods and services provided by the AT&T under its "license contracts" to its corporate subsidiaries, the Bell operating companies, were issues of litigation and dispute for many years.[4] The level of compensation to service corporations affiliated with the new regional Bell operating companies (BOCs) is still an area of concern and dispute.[5]

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[1] Communications Act of 1934, 47 U.S.C. sections 151, et seq.; and Ala. Code (1975) sections 37-1-1, et seq.

[2] But see Second Computer Inquiry, 77 FCC2d 384 (1980), on reconsideration, 84 FCC2d 50 (1980), on further reconsideration, 88 FCC2d 512 (1981), (hereinafter collectively cited as *Computer II*), aff'd, *Computer and Communications, Inc.* v. *FCC*, 693 F.2d 198 (DC Cir. 1982) (hereinafter cited as CCIA) (FCC exercised implied Title I jurisdiction to require structural separations for the sale of CPE).

[3] See *Bluefield Waterworks & Imp. Co.* v. *Public Service Comm.*, 262 U.S. 679 (a public utility is entitled to such rates as will permit it to earn a return ... equal to that generally being made ... in the same general part of the country on investments in other business undertakings which are attended by corresponding risks); *West Ohio Gas Co.* v. *Public Utilities Comm.*, 294 U.S. 63 (1935) (waste or negligence must be established by evidence of one kind or another, either direct or indirect ... Good faith is to be presumed on the part of the managers of a business); and *Alabama Public Serv. Com'n* v. *Southern Bell T. & T.*, 253 Ala. 1, 42 So.2d 655 (1949).

[4] Cf, *Smith* v. *Illinois*, 282 U.S. 133 (1930).

[5] Eg., NARUC, *1982 Report of the Ad Hoc Committee on Utility Diversification*, 1982; NRRI, *Unregulated Enterprises of the Bell Regional Holding Companies*, 1986; and NARUC Staff Subcommittee on Accounts, *Audit Report on BellSouth Inc.*, 1986.

The inability of utility regulators to prohibit non-integrated diversification, and to prohibit and/or regulate transactions between corporate affiliates poses an increasing problem. Utility regulators are loosing control over the monopoly power and monopoly profits of regulated utilities because of the inability to prevent cross-subsidization between regulated and unregulated corporate divisions and affiliates.

Antitrust Regulation

The antitrust laws generally prevent privately owned companies from conspiring with each other to eliminate other companies from a market,[6] and from unilaterally using their own monopoly power to eliminate potential competitors.[7]

If a regulated utility refuses to comply with the clearly articulated rules of a regulatory body or cannot prove that it is acting pursuant to a clearly articulated state policy, then that utility should be open to antitrust prosecution. In the AT&T divestiture proceeding, AT&T was prosecuted by the Justice Department for antitrust violations, Judge Greene found that AT&T refused to comply with the interconnection and equal access directives of the FCC, and the Justice Department and AT&T agreed to a settlement imposing certain business restrictions.[8]

Deficiencies of Antitrust Laws

Government regulations has traditionally protected privately owned telephone companies from the application and enforcement of antitrust laws under the doctrines of "primary jurisdiction" and "state action exemption." Judicial interpretations have restricted the application of the antitrust laws from intra-company activities, and the federal and state agencies responsible for presecuting public violations of the antitrust laws are not adequately staffed and are under funded.

The antitrust prohibitions against predatory pricing, refusal to deal, tying arrangements, and predatory new product innovations are frequently violated by regulated utilities under the umbrella of government regulation. The traditional goals of utility regulation can only be accomplished by maintaining the monopoly profits of the regulated telephone companies. Government regulators, therefore, allow and encourage regulated utilities to engage in anti-competitive practices in order to protect the monopoly power and monopoly profits of telephone companies.

The state action immunity of private defendants has strengthened over the past decade. The Supreme Court relied on principles of federalism and state sovereignty in *Parker* v. *Brown*[9] to conclude that the Sherman Act was not intended to prohibit anti-competitive acts of the states.[10] This doctrine has been extended to private actions provided (a) the challenged restraint on competition must be clearly articulated and affirmatively expressed as state policy, and (b) the policy must be actively supervised by the state itself.[11] The MidCal standard was recently extended to state policies which permit but do not compel anti-competitive conduct.[12]

Over the past decade the federal courts have reduced the ability of the FCC to protect telephone companies from antitrust laws under the doctrine of "primary jurisdiction".[13] In *Otter Tail Power Co.* v. *United States*, the majority held that electric subtransmission services are not "common carrier" service under the Federal Power Act[14] and, therefore, the antitrust laws and the orders of the District Court were not in conflict with proceedings pending before the Federal Power Commission.[15] Mr. Justice Stewart with whom Mr. Chief Justice Burger and Mr. Justice

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[6] Sherman Antitrust Act, Section 1, 15 U.S.C. section 1.

[7] Sherman Antitrust Act, Section 2, 15 U.S.C. section 2.

[8] See *United States* v. *Am. Tel. & Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1982) (hereinafter cited as MFJ). In section VIII-C of the order, at page 231, Judge Greene modified the restrictions contained in secton II-D of the settlement proposed by AT&T and the Justice Department (hereinafter referred to as Justice) and allowed the BOCs to engage in certain unregulated activities. Justice and the BOCs have not petitioned the court to remove the section II-D restrictions at this time.

[9] *Parker* v. *Brown*, 317 U.S. 341 (1943).

[10] Id. at 350-351.

[11] *California Retail Liquor Dealers Association* v. *Midcal Aluminum, Inc.*, 445 U.S. 97 (1980).

[12] *Southern Motor Carriers Rate Conference, Inc.* v. *United States*, 85 L.Ed. 2d 36 (1985); and Mandt, the State Action Immunity Doctrine: a Reassessment, 47 Ala. Law. 136 (1986).

[13] Cf., *Otter Tail Power Co.* v. *United States*, 411 U.S. 428 (1973) (Douglas, Brennan, White and Marshall; Stewart, Burger and Rehnquist, dissenting; Blackmun and Powell, took no part); *United States* v. *Am. Tel. & Tel. Co.*, 427 F. Supp. 57 (D.D.C. 1976) (Waddy, J.); and *United States* v. *Am. Tel. & Tel. Co.*, 461 F. Supp. 1314 (D.D.C. 1978) (Greene, J.).

[14] Federal Power Act, section 202(b), 16 U.S.C. section 824a(b).

[15] *Otter Tail Power Co.* v. *United States*, supra n. 13 at 376. Also note that the Federal Power Commission was renamed the Federal Energy Regulatory Commission in 1976.

Rehnquist joined dissenting argued that in the absence of horizontal conspiracy District Courts should defer to other regulatory agency proceedings in progress.[16]

During the AT&T divestiture proceeding, the District Court twice rejected AT&T's argument that the FCC had exclusive jurisdiction over the subject matter of the litigation.[17] Judge Greene restated the principal that "repeals of the antitrust laws by implication from a regulatory statute are strongly disfavored ...."[18] and that "[r]egulated industries' are not per se exempt from the Sherman Act' (citation omitted) ...."[19] Judge Green also summarized the exceptions to these principals as follows:

Regulated conduct is, however, deemed to be immune by implication from the antitrust laws in two (footnote omitted) relatively narrow instances: (1) when a regulatory agency has, with congressional approval, exercised explicit authority over the challenged practice itself (as distinguished from the general subject matter) in such a way that antitrust enforcement would interfere with regulation (citations omitted) and (2) when regulation by an agency over an industry or some of its components or practices is so pervasive that Congres is assumed to have determined competition to be an inadequate means of vindicating the public interest. (citations omitted).[20]

The FCC appeared in the AT&T divestiture proceeding as amicus curie and only opposed the court's jurisdiction in three limited areas.[21] Judge Greene found that Western Electric and Bell Laboratories were substantial participants in the alleged antitrust violations and that they were not subject to the FCC's jurisdiction even though they are corporate subsidiaries of AT&T.[22] Judge Greene also found that the FCC has "no authority to alter, regulate, or otherwise to interfere with AT&T's internal structure, including its relationships with Western Electric and Bell Labs."[23] Judge Greene also stated that the FCC was not pervasively regulating the telecommunications industry and had in fact adopted policies of regulatory restraint because of its inability to keep up with the voluminous tariff filings.[24] Even though both Judge Waddy and Judge Greene held that the FCC did not have exclusive primary jurisdiction over AT&T, they both deferred to the FCC's jurisdiction, as it requested, on issues of certification and interconnecton, and matters specifically approved by tariff.

The Court of Appeals for the D.C. Circuit recently stated that the expansive restrictions and supervisory authority contained in the MFJ are "consistent with the Supreme Court's recent recognition that, under the antitrust laws, corporations and their wholly owned subsidiaries function as a single enterprise. Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984).[25] In Copperweld, the Court held that Section 1 of the Sherman Act[26] (prohibiting restraints of trade) does not apply to intra-company conduct. As a result of this decision, only the less restrictive provisions of Section 2 of the Sherman Act[27] (prohibiting monopolization) will apply to holding-company activities. It is clear that the Copperweld case limited and did not expand the application of the antitrust laws to intra-company conduct.[28]

The Justice Department would have had a much more difficult job of regulating and monitoring the holding company activities of the BOCs under the antitrust laws if AT&T had not agreed to the line of business restrictions and the oversight provisions in the MFJ.

Regulators are finding it harder and harder to maintain monopoly power. The effects of the unavoidable "bypass" of regulated services by unregulated competitors has caused regulators to reconsider the benefits of maintaining the declining monopoly power of the telephone companies and to consider the benefits of encouraging competition. It is axiomatic that if there are no monopoly profits then there is no need for rate regulation.

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[16] Id., at 391-392.

[17] *United States* v. *Am. Tel. & Tel. Co.*, 427 F. Supp. 57 (D.D.C. 1976) (Waddy, J.); and *United States* v. *Am. Tel. & Tel. Co.*, 461 F. Supp. 1314 (D.D.C. 1978) (Greene, J.).

[18] *United States* v. *Am. Tel. & Tel. Co.*, 461 F. Supp. at 1321.

[19] Id. at 1322.

[20] Id. at 1322-1323.

[21] The FCC rquested that the court refrain from exercising jurisdiction over (1) Section 214 entry certification matters, (2) Section 201 interconnection requirements previously adopted, and (3) Section 205 rates and services approved by tariff. *United States* v. *Am. Tel. & Tel. Co.*, 427 F. Supp. at 59.

[22] *United States* v. *Am. Tel. & Tel. Co.*, 461 F. Supp. at 1324.

[23] Id. at 1325.

[24] Id. at 1326.

[25] *United States* v. *Western Electric Co., Inc.*, Civil Nos. 86-5118, 86-5163 and 86-5164 (DC Cir. August 15, 1986) (Mikva, Scalia and Buckely, J.).

[26] Sherman Antitrust Act, Section 1, supra n. 6.

[27] Sherman Antitrust Act, Section 2, supra n. 7.

[28] *Mobil Oil Corp.* v. *Blanton*, 105 S. Ct. 1874 (1985) (Mr. Justice White dissented from the denial of cert. on the grounds that the Copperweld decision should be extended to limit the liability of intra-company activities under Section 2 of the Sherman Act as well as Section 1 violations).

Public Utility Holding Company Regulation

The Public Utility Holding Company Act of 1934[29] applies only to electric and natural gas holding comapnies and does not apply to telephone holding companies, such as the BOCs, but the provisions of this act are similar to the provisions of the MFJ. In Part VI of the MFJ, the Justice Department has the authority to supervise the activities of the BOC holding company system.[30] In Parts II-D(3) and VIII-C of the MFJ, the court retained the authority to supervise restrictions against non-integrated diversification.[31]

The Public Utility Holding Company Act gives the Securities and Exchange Commission (SEC) the authority "to limit the operations of the holding-company system ... to a single integrated public-utility system.[32] The act also limits the ability of the holding company system to make intra-company loans and dividend payments.[33] The act also gives the SEC supervisory and regulatory authority over the level of contribution for goods and services between members of the holding company system.[34] It is clear that the SEC has substantial powers to supervise and control transactions within the holding company system and to cause non-integrated services of electric and natural gas holding companies to be divested.

It may be appropriate for Congress to amend the Public Utility Holding Company Act to include telephone companies, because neither utility regulators nor the antitrust laws clearly contain the type of regulatory authority needed to control and supervise the holding company activities of telephone companies.

If Congress determines that the FCC and not the SEC should be given regulatory authority over holding company activities then Congress should consider transferring similar authority to the Federal Energy Regulatory Commission over electric and natural gas companies.

It is important to note that the Public Utility Holding Company Act does not substantially infringe on states rights and has been interpreted not to be as expansive as the Commerce Clause.

Changing Federal Policies

The FCC and federal courts have shifted their policy toward the regulation of the telecommunications industry from the traditional concept of monopoly regulation to a policy of minimal regulation in a competitive environment. It is hard to identify a particular decision or a particular period of time which marks this change. The change has come about in an accelerating transition from the early 1960s.[35] A great deal of the change has been ordered by federal courts, but in the past five to ten years the FCC has been a full partner in the movement toward deregulating the telecommunications industry.[36]

The federal courts and the FCC are currently testing the policy of deregulation on a service-by-service basis,[37] but neither the FCC nor the federal courts are willing to consider total and immediate deregulation of the entire telecommunications industry.

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[29] Public Utility Holding Company Act, 15 U.S.C. sections 79, et seq.

[30] *United States* v. *Am. Tel. and Tel. Co.*, 552 F. Supp. at 230-231.

[31] Id. at 227-228 and 231.

[32] Public Utility Holding Company Act, supra n. 29, section 79k(b).

[33] Public Utility Holding Company Act, supra n. 29, section 79l.

[34] Public Utility Holding Company Act, supra n. 29, section 79m.

[35] Possibly the first evidence of this policy is Hush-a-phone, 22 FCC 2d 112 (1957), leading to Carterfone, 13 FCC 2d 420, reconsideration denied, 14 FCC 2d 571 (1968), aff'd, 365 F. 2d 486 (DC Cir.); and Second Computer Inquiry, supra n. 2, aff'd, CCIA supra n. 2.

[36] Compare *Carter* v. *Am. Tel. and Tel.*, 250 F. Supp. 188 (1963), aff'd, 365 F. 2d 486, (5th Cir. 1966), and *Carterfone*, 13 FCC 2d 420, reconsideration denied, 14 FCC 2d 571 (1968), aff'd, 356 F. 2d 486 (DC Cir.); to *MCI Telecommunications Corp.* v. *FCC*, 561 F. 2d 365 (DC Cir. 1977), cert. denied, 434 U.S. 1040 (1978) (hereinafter cited as *Execunet I*); *MCI Telecommunications Corp.* v. *FCC*, 580 F. 2d 590 (DC Cir. 1978)(hereinafter referred to as Execunet II), cert. denied, 439 U.S. 980 (1978), and *MTS and WATS Market Restructure*, Docket 78-72; to *United States* v. *Am. Tel. and Tel. Co.*, 427 F. Supp. 57 (D.D.C. 1976)-(Waddy, J.), 461 F. Supp. 1314 (D.D.C. 1978) (Greene, J.), 552 F. Supp. 131 (D.D.C. 1982); and to *Computer II*, supra n. 2, aff'd, CCIA, supra n. 2.

[37] See, *United States* v. *Am. Tel. and Tel.*, 552 F. Supp. 131 (D.D.C. 1982) (Section VIII-C, p. 231, provides for judicial line of business waivers); and Computer II, supra n. 2 (FCC deregulated CPE subject to structural separations and enhanced services).

Many objections have been raised to this shift in regulatory policy and the methods chosen to implement it. The primary objection raised by state regulators and consumer groups is the lack of evidence that competition is viable in the market place with respect to the particular services chosen to be deregulated.[38] The utility companies, state regulators and consumer groups also object to the cost shifts which occur in the wake of deregulation.[39]

Problems of Transition

If competition is viable then new investment capital would be attracted to any profitable market. Relative ease of entry and exit should exist in the market place, which means that equipment and labor are readily available to provide the service proposed to be deregulated. The concept of competition in a predominantly monopolistic industry, however, is antithetical, and the problems of transition pose complex public interest questions.[40]

The transformation of a monopolistic industry, which has developed highly technical engineering, management and accounting skills under the protection of federal and state regulators, poses a difficult problem. Access to this technical information and a willingness of the regulated utilities to allow interconnection with the integrated wire and radio network has presented and will present a serious stumbling block for potential competitors in the future.[41]

State Policies: Who Decides

Many questions which affect legitimate state interests are still undecided. Would a competitive environment accommodate the highly technical and integrated network which has developed under monopoly regulation? Which companies and/or services should be deregulated? Can monopoly regulation be resumed after deregulation? What will be the socio-economic effects of deregulation? What safeguards, other than traditional utility regulation, are available to protect the public interest?

The issue of who makes the public interest decision to regulate or deregulate has been a constant source of conflict between the FCC, the federal courts, and the state regulators. The preemption of state regulatory authority by the FCC has resulted in numerous appeals since the early 1970s.[42]

Legislative Action

Until recently, Congress and state legislators have not participated either in the shift in policy toward deregulation, or in the power struggle between federal and state regulators and the federal courts.[43] Legislative authority to make public interest determinations with respect to the telecommunications industry has been delegated to regulatory agencies and to federal courts in antitrust actions. Congress has the Constitutional power to regulate any activity which substantially affects interstate commerce, and most likely could preempt the entire field of telecommunication regulation if it so chooses.[44] A national system of utility regulation or deregulation should not be entered into without serious thought and an appreciation for the variety of social and geographic problems across the nation.

Congress has awakened to the struggle between regulators and the courts and is considering legislation for the purpose of removing power from the federal courts under the antitrust laws.[45] None of the proposed legislation, however, directly modifies the antitrust laws or indirectly changes the "primary jurisdiction" of the federal courts over activities regulated by the FCC.[46]

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[38] See, Detariffying of Inside Wiring, Docket 79-105, Second Report and Order, FCC 86-63, summarized, 51 Fed. Reg. 8498 (1986) (the comments of the Alabama Public Service Commission and the Michigan Public Utility Commission are cited in Section IV, paragraph 10.)

[39] The deregulation of telephone sets (CPE) in Computer II caused local rates to increase by approximately five dollars per month for South Central Bell customers in Alabama, In the Matter of South Central Bell, APSC Docket 18882 (1984). See also, the FCC's Monitoring of Residential Telephone Service, GAO/RCED-86-146 (GAO found that the FCC is not adequately monitoring the effects of its policy changes on residential ratepayers).

[40] See, *Third Computer Inquiry*, 50 Fed. Reg. 33581 (August 16, 1985) Notice of Proposed Rulemaking (hereinafter cited as Computer III).

[41] See *Execunet I*, supra n. 32; *Execunet II*, supra, n. 36; and *United States* v. *Am. Tel. and Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1980).

[42] Denying preemption: see, *Louisiana Pub. Serv. Com'n* v. *FCC*, 106 S. Ct. 1890 (1986); and *California* v. *FCC*, Civil No. 85-1112 (DC Cir. August 22, 1986). Affirming preemption: see, *Nat'l Ass'n of Reg. Util. Com'rs* v. *FCC*, 525 F. 2d 630 (DC Cir. 1976) (activities not undertaken to carry for all people indifferently are not "common carriers" and jurisdiction is not reserved to states under 152(b)); and *Computer and Communications, Inc.* v. *FCC*, 693 F. 2d 198 (DC Cir. 1982) (state action which frustrates the goals of the FCC may be preempted).

[43] Several states have enacted legislation deregulating various telecommunications services.

[44] U.S. Const. art. III, Commerce clause and art. VI, Supremacy Clause. See *Nickard* v. *Filburn*, 317 U.S. 495 (1935); *Oklahoma* v. *FERC*, 494 F. Supp. 636 (1980); and *Fidelity Federal Savings & Loan Assn.* v. *De la Cuesta*, 458 U.S. 141 (1982) (Federal agency acting within the scope of its congressionally delegated authority may preempt state regulaton).

The Dole bill preempts state regulator authority by not including the statutory limitations on the jurisidiction of the FCC contained in section 152(b) of the Communications Act of 1934.[47] Without the statutory protection of section 152(b), states would no longer have the power to regulate the telecommunications industry.[48]

The proposed legislation does not directly authorize the FCC to deregulate intrastate telecommunication services, but it does authorize the FCC to allow or prohibit regulated utilities to engage in unregulated activities similar to the provision of Part VIII(C) of the MFJ. These new powers would give the FCC preemptive authority over the states to deregulate wholly intrastate services.

The FCC already has the power to definitionally deregulate appropriate services,[49] and the ability to expand, ease or eliminate regulations over particular services.[50] Definitional deregulation has been an adequate tool for federal and state regulators to draw the line between services, products, equipment and employees which should be subject to regulations and those which should not. There is no need to enhance the FCC's powers to deregulate at this time.

The ability of regulated carriers to provide regulated and unregulated services will intensify the need for increased regulation to prevent the cross-subsidization of unregulated activities by regulated activities.[51]

State regulatory agencies provide most of the auditing capability with which the telecommunications industry is monitored, and the federal government does not have the resources or management capability to replace these monitoring functions.

If the telecommunications industry is to be deregulated in whole or in part, it is clear that federal and state authorities must cooperate.

Conclusion

It may be appropriate to subject telephone companies to the Public Utility Holding Company Act to minimize non-integrated diversification of telephone companies. The Dole bill does not effectively address the issue of primary jurisdiction and does not give the FCC additional authority to regulate the corporate structure of telephone companies or the level of compensation between corporate affiliates.

The assault on the sovereignty of the states and the federal system of government implied by the Dole bill and other pending Congressional legislation is far too important for the states to ignore. State governments have a vital interest in the regulation of intrastate telecommunications.

STATEMENT OF THE TELE-COMMUNICATIONS ASSOCIATION

Tele-Communications Association hereby respectfully submits its written testimony in response to the invitation of Chairman Danforth for comment on S. 2565 and, in particular, Chairman Danforth's proposed amendments. TCA welcomes this opportunity to express its members' views on the effect of the legislation and the Danforth proposals on ratepayers and hopes that these comments will assist the Committee in considering any legislation regarding the substance or forum for administration of the Modified Final Judgment.

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[45] HR 3800 (Tauke bill), Telecommunications Equity Act of 1986, SB 2362 (Gore bill), and Telecommunications Industry Development Act of 1986, SR 2565 (Dole bill). Specifically, Congress appears to be concerned with the restrictions contained in Section II D of the MFJ. *United States* v. *Am. Tel. & Tel. Co.*, 552 F. Supp. at 227 and 228.

[46] *United States* v. *Am. Tel. and Tel. Co.*, 427 F. Supp. 57 (D.D.C. 1976) (Waddy, J.), 461 F. Supp. 1314 (D.D.C. 1978) (Greene, J.) (issue of primary jurisdiction reconsidered by Judge Greene after transfer of case from Judge Waddy, deceased); and n. 17 supra.

[47] Memorandum Concerning Federal Telecommunications Policy Act of 1986, Detailed Analysis of the Bill, Congressional Record-Senate, June 18, 1986, page S. 7751 ("limitations placed on the [FCC's] jurisdiction under the 1934 Act by 47 U.S.C. 152(b) would not apply to the Commission's jurisdiction under the Bill.")

[48] *Louisiana Pub. Serv. Com'n* v. *FCC*, 106 S. Ct. 1890 (1986).

[49] See, *Computer II*, supra n. 2.; and *Computer III*, supra n. 40.

[50] Competitive Carrier Regulation, First Report and Order, 85 FCC 2d 1 (1981) (establishing the principal of forebearance from regulation), Sixth Report and Order, 57 RR 2d 1391 (1985), vacated and remanded, *MCI Telecommunications Corp.* v. *FCC*, 765 F. 2d 1186 (DC Cir. 1985) (mandatory forebearance not allowed).

[51] See the issues pending before the FCC in Docket 86-111 in which the FCC proposes to adopt accounting rules for unregulated activities and affiliate transactions. Also see the resolution adopted by the Executive Committee of the National Association of Regulatory Utility Commissioners at the 1986 Mid-Summer Conference in which NARUC questions the FCC's jurisdictional authority to prescribe accounting practices for intrastate services.

STATEMENT OF INTEREST

TCA is an association of telecommunications managers. Its members represent more than 1,000 telecommunications users, including state and local governments, hospitals, corporations, universities, and other small, medium and large institutions throughout the States of Arizona, California, Colorado, Oregon, and Washington. TCA's members are sophisticated users of the full range of telecommunications services and products. As such, TCA is vitally interested in the effect that any legislation in this area will have on the availability and cost of telecommunications services to its members and, ultimately, the cost of local government operations, education, health care and a variety of other services and products offered by TCA's members.

BACKGROUND

TCA has previously communicated its concerns to the Committee in response to Chairman Danforth's earlier request for comments "on whether Congress should amend the consent decree that restructured the U.S. telephone industry." In those comments TCA took no position with respect to the wisdom of alowing BOC expansion into new businesses,[1] but noted that to do so was to create enormous potential risks for ratepayers—especially if Congress provided no guidelines for the FCC. TCA emphasized that if legislation were enacted, Congress, at a minimum, should prohibit RBOCs from using local telephone revenues, assets or personnel to subsidize unregulated business activities. In addition, TCA urged that the BOCs' regulated local telephone service—and, ultimately, the users of such service—must be insulated from potential financial reverses occasioned by the BOCs' unregulated new business ventures. TCA also pointed out that if assets, personnel or information is shared or transferred, public telephone ratepayers must be appropriately compensated.

Events since the filing of those comments—particularly the growing concern in Congress and among users and businesses regarding the unfettered discretion which S. 2565 gives the FCC—have reaffirmed TCA's earlier convictions. In the House, Representatives Swift and Tauke have proposed the Telephone Ratepayer Protection Amendment to H.R. 3800.[2] TCA has already announced its strong support for this amendment since it goes a long way toward meeting ratepayers' concerns. Representative Wyden has offered another approach to ratepayer protection—an effort supported by Representatives Markey, Luken, Bryant, Leland and Synar.[3] In the Senate, Chairman Danforth has submitted proposed amendments to S. 2565—also aimed at protecting ratepayers. TCA supports this continuing process to find the best appropriate provisions to safeguard ratepayers and competition.

THE DANFORTH PROPOSALS

With this background, TCA submits the following comments concerning some of the proposals and questions raised by Chairman Danforth.

(1) Findings

TCA agrees that "universal availability of affordable telephone service" and the preference for "competition rather than government intervention" are laudable goals. However, TCA believes that there are other principles which should guide the Committee in this consideration of legislation. For example, as detailed below, TCA believes that it is imperative that safeguards be in place to protect ratepayers from any risk or potential for subsidizing the competitive ventures of the BOCs. TCA also urges that Congress seek to assure interconnection rights of competitive and private systems.

Moreover, TCA believes that no legislative findings should be interpreted as "code words" for the unbridled discretion of RBOCs. TCA believes that any deregulation of the RBOCs should be allowed only when marketplace forces are sufficient to assure effective competition and that procedures must be in place to re-impose regulation when required by marketplace changes.

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[1] TCA did point out, however, that considerable BOC diversification has already taken place under current MFJ waiver procedures.

[2] 132 Cong. Rec. E 2989 (August 15, 1986) (remarks of Mr. Swift).

[3] 132 Cong. Rec. H 6428 (August 15, 1986) (remarks of Mr. Wyden).

(2) Waiver, Modification or Elimination of Current Restrictions

The process for waiver of consent decree restrictions contained in the Danforth proposals envisions FCC consultation with various executive branch agencies before granting any waiver. While TCA agrees that the opinion of these agencies may prove useful to any FCC determination, a formal system of coordination with at least four separate executive agencies may prove unwieldy. If the assumed benefit of S. 2565 is to provide for swifter resolution of waiver requests, it is difficult to see how this undefined and cumbersome consultation will serve that goal.

Moreover, TCA believes that in fairness to ratepayers, any process of intra-governmental consultation should not take place in secret but rather in the context of a public proceeding in which users and other interested parties may participate. As Secretary Sikes said at the September 11 hearings with reference to decree court proceedings, questions raised by the MFJ restrictions are not private but public issues. TCA believes that there would be no benefit in substituting a closed-door proceeding for a public court proceeding. And TCA urges that a public process will also develop the best record for informed decision making by the FCC or any other government agency.

As to the criteria for waivers, TCA again urges that none of the criteria be used as a screen for unchecked BOC discretion. This is especially true for any intangible criteria such as "U.S. trade benefits" and "implications for national security." In addition, as explained in more detail below, TCA believes that any waiver, modification or elimination of restrictions should depend on the availabiity of comparably efficient interconnection. These critera have also been proposed as part of the Swift-Tauke Amendment to H.R. 3800.

As to the "relevant market" question raised by Chairman Danforth, TCA has previously indicated in its comments in the Justice Department's Huber Study that this area is characterized by four product and service markets: (1) transmission services; (2) customer premises equipment; (3) information services; and (4) installation and maintenance. As explained in those comments, TCA believes that the CPE market is vigorously competitive, that the information services market is, by and large, highly competitive and that competition in the installation and maintenance market is generally item-specific. The transmission services market, of course, continues to be characterized (both geographically and according to service) by various levels of competition—from interstate switched service, such as that provided by AT&T and the BOCs, which is characterized by some competition, to local exchange service, which remains non-competitive.

(3) FCC/State Regulation

Of central concern of TCA's members is effective regulation to ensure that users do not unfairly fund the RBOCs' unregulated ventures. This is why TCA strongly supports the Swift-Tauke amendment, which specifically prohibits cross-subsidization and requires the FCC "to prescribe rules to carry out" this prohibition. TCA believes that this may best be carried out by requiring the FCC to promulgate cost assignment and cost allocation rules which are consistent with FDC principles and which maximize direct assignment of costs.

A similar concern was expressed by several Committee members during the September 11 hearings. As Senator Exon said, the potential harm to ratepayers is a "legitimate concern that tends to get lost." And without explicit guidelines for the FCC to follow, as Chairman Danforth pointed out, the Commission might simply "go to it" and give the RBOCs unfettered discretion.

TCA also notes that the need for close regulatory observation comes at a time of limited resources for FCC staff. This situation is suggested by Chairman Danforth's question as to whether the Commission should be allowed to accept certification of outside public accountants in lieu of conducting its own audits. In TCA's view, the Commission must intimately involve itself in periodic audits in order to make its independent public interest determination that no cross-subsidization is taking place. This determination should be at the heart of the Commission's responsibility under S. 2565 and ought not be delegated to "outside public accountants."

TCA believes that the States are not only hampered by limited resources but in many instances by a lack of uniformity among the States on matters such as cost allocation. This was recently illustrated in the Huber Study comments of the Telecommunications Committee of the Western Conference of Public Service Commissions. There, the Committee noted that while "[c]onventional practice has used cost allocation factors in a fully distributed cost study to allocate joint and common costs to the various services[,] . . . [t]he absence of a consensus on these cost allocation factors precludes state commissions from having confidence that cross-subsidization has been effectively prevented."

Even so, as TCA has argued in Phase I of the FCC's Third Computer Inquiry, TCA believes that the States must retain substantial authority to take regulatory action to make sure that ratepayers are properly protected. In fact, TCA has urged the FCC to clarify the extent of its Computer III preemption to find that States have the responsibility to ensure that carriers subject to state jurisdiction are not allowed to take advantage of their monopoly ratepayers. *Consolidated Opposition of Tele-Communications Association to Petitions for Reconsideration* (CC Docket No. 85-229) at 26.

(4) Asset Transfers

TCA continues to believe that any transfer of assets, information or personnel should be made only at fair market value.[4] TCA understands this to be the thrust of the Swift-Tauke amendment to H.R. 3800, which provides that the FCC shall establish rules governing the "transfer of assets" between "a company providing telephone service and related companies" in order to "protect the interests of ratepayers of telephone service. TCA applauds this effort and merely suggests that any final version clarify that the provision applies to assets, information or personnel and that transfers to unregulated operations be made only at fair market value. In addition, the determination of what constitutes fair market value should be made only after opportunity for public comment.

(5) Interconnection

TCA believes that ultimately, open network architectures offer a promising avenue of equal access for users. In the short term, however, TCA supports the efforts to develop comparably efficient interconnection. To this end, TCA agrees with the purpose of section 4(b) of the Swift-Tauke Amendment that RBOC entry into information services shall be available only if there are in effect rules prescribed by the Commission whch ensure that other information service providers have opportunities for interconnection to the telephone service facilities of the Bell operating company which are comparable to the interconnection provided by the Bell operating company to itself or to any affiliate of such company. 132 Cong. Rec. E2989 (August 15, 1986).

As the Joint Explanation of this provision makes clear, it gives the BOCs every incentive to ensure that others have a fair opportunity to compete and assures that, to the extent new services require use of the existing telephone networks, there will be a sharing of network costs not only by the BOCs, in their role as information service providers, but also by others offering information services. 132 Cong. Rec. E2990 (August 15, 1986).[5] TCA believes that these CEI proposals are large steps in the right direction although they do not solve all the problems.

(6) Financing

TCA believes that the Swift-Tauke Amendment likewise provides a reasonable touchstone with regard to financing issues. Section 6(e) of the Amendment requires the Commission to ensure that costs incurred in the line of business shall not be reassigned to the telephone service "except upon a showing that the customers of telephone service will benefit." Moreover, the Amendment prohibits any structurally separate business venture from obtaining credit "under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the telephone service affiliate." 132 Cong. Rec. E2989 (August 15, 1986). As the Joint Explanation states, the amendment will "insulate ratepayers from having to pay for failed ventures ... Any losses will have to be absorbed by shareholders or by other competitive lines of business." 132 Cong. Rec. E2991 (August 15, 1986). TCA believes that these are reasonable proposals that represent the minimum protection necessary to safeguard ratepayers if new business fail.

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[4] As TCA pointed out in its July 3 comments to the Committee, the need for safeguards in this area is graphically illustrated by a recent staff study of the California Utility Commission on Pacific Bell's relations with its affiliates. The staff report concluded among other things, that (1) "Pacific Bell and its ratepayers were [not] adequately compensated for the value of experts and managers permanently transferred or loaned to the affiliates"; (2) "properties were transferred [from Pacific Bell] to PacTel Properties below fair market value, thus short changing the ratepayers;" and (3) Pacific Bell and its ratepayers "are not being adequately compensated for the customer referrals Pacific Bell is providing to its affiliates." PacTel Report, Executive Summary at 2, 3.

[5] Again, it is important that the costs associated with developing ONA and CEI be allocated so as not to shortchange ratepayers. Since these advances are essentially caused by the necessity of protecting competition because of the entry of a monopoly into competitive ventures, TCA believes that the costs of developing ONA and CEI should be attributed largely to the BOCs' new competitive ventures.

(7) Separate Subsidiaries

TCA now believes that it would be reasonable to require that new businesses which are not telecommunications-dependent should be operated separate subsidiaries. This is the simplest and most prudent way to make cross-subsidization more difficult since it makes intracompany transactions more obvious. It should also have the added benefit of reducing common costs. This restriction, if made statutory, would also ensure that the FCC will be unable to engage in what Representative Markey has described as a "willingness to abandon structural separation requirements in the absence of adequate alternatives," a practice that reveals "a propensity to jump off the diving board before checking the pool." 132 Cong. Rec. H6431 (August 15, 1986); remarks of Mr. Markey).

(8) Judicial Review

As a final matter, TCA notes that pursuant to the Commission's interpretation of *Papago Tribal Utility Authority* v. *F.E.R.C.*, 628 F. 2d 235, *cert. denied*, 449 U.S. 1061 (1980), the Commission has taken the position that a number of its proceedings are not subject to judicial review.[6] TCA urges that any legislation make clear to the Commission that its decisions regarding the MFJ are subject to court scrutiny.

CONCLUSION

TCA again urges the Committee to weigh the interests of ratepayers in any legislation regarding the current restrictions on the RBOCs. TCA appreciates this opportunity to convey its members' continuing concerns and hopes to be able to be of assistance to the Committee in providing any further information or comments.

STATEMENT OF DONALD VIAL, PRESIDENT CALIFORNIA PUBLIC UTILITIES COMMISION

Mr. Chairman and Members of the Committee, my name is Donald Vial. I am the President of the California Public Utilities Commission ("CPUC"). I am filing these comments on behalf of the CPUC. The CPUC is an administrative agency established under the Constitution and the laws of the State of California. Pursuant to state law and the Communications Act of 1934, 47 U.S.C. 152(b) and 221(b) ("1934 Communications Act" or "Act"), the CPUC exercises general regulatory jurisdiction over intrastate communications carriers to ensure that conditions of entry and service, and the level of rates, are reasonable. In exercising its duties, the CPUC is charged with protecting the interests of the people of California. As a part of this responsibility we take a strong interest in S. 2565, the proposed Federal Communications Policy Act of 1986, and the amendments to that proposed Act that Chairman Danforth has put forth. We appreciate the opportunity to comment to you on S. 2565 and the amendments.

The essential objective of S. 2565 is to transfer the day-to-day oversight of the AT&T and GTE consent decree from the arena of the courts to the arena of the regulatory commission. We believe that this is a laudable goal. The administration of the consent decrees has become a much more elaborate and cumbersome process than anyone could have expected when the decrees were entered into in 1982. Specifically, the oversight of the decrees has drawn the District Court into the detailed, day-to-day regulation of the telecommunications industry. This is not a role for which the court is well-suited. As Senator Dole indicated when he introduced S. 2565: Congress never intended that the anti-trust enforcement machinery be used for the long term, day to day regulation of industries ... The expert regulatory agency has the resources to address these subtleties—and on a continuing basis. (Congressional Record, June 18, 1986, S. 7743).

Whoever oversees the consent decrees must decide whether telephone companies should be able to diversify into services now prohibited by the decrees. This form of diversification carries with it both potential risks and potential benefits to consumers, investors, and the nation as a whole. There are many reasons to believe that a full time regulatory commission is better situated than a court to evaluate these risks and benefits and to make detailed judgments about the desirability of diversification into each activitiy now prohibited by the decrees. Specifically, a regulatory agency has greater expertise and technical resources than a court, such that it is generally much better equipped than a court to act in a thorough and expeditious manner. Regulators are also in a better position to ensure that the benefits of diversification are achieved while imposing rules that minimize the accompanying risks.

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[6] This issue is now before the United States Court of Appeals for the District of Columbia Circuit in *U.S. Sprint Communications Co.* v. *Federal Communications Commission*, Case No. 86-1413.

While the basic objective of S. 2565 is laudable, the proposed method of achieving this goal is seriously flawed and renders the measure unsupportable in its present form. The method that is proposed in the Bill is essentially to transfer oversight of the decrees from the U.S. District Court of the District of Columbia to the Federal Communications Commission ("FCC"). The problem with this method is that it greatly expands the reach of the Federal Communications Commission and thereby substantially alters the existing federal/state jurisdictional balance in telecommunications. Is this a sensible policy? We believe not. It is not necessary, nor desirable, for Congress to drastically change the existing federal/state jurisdictional balance in telecommunications in order to give the day-to-day regulation of the industry back to the regulators. Indeed, this fundamental jurisdictional change is likely to thwart the very goals of S. 2565 itself.

We should be clear that S.2565 would significantly alter the federal/state jurisdictional balance in telecommunications. The Memorandum accompanying S. 2565 states that the "limitations placed on the Commission's [FCC's] jurisdiction under the 1934 Act by U.S.C. 152(b) would not apply to the Commission's jurisdiction under the Bill." These are precisely the limitations in the 1934 Communications Act which preserve jurisdiction over intrastate services for the states.

Some may argue that the Bill only preempts the states in a single narrow area of regulatory activity, leaving the federal/state balance envisioned by the 1934 Communications Act in place for most communications services. For example, the Memorandum accompanying the Bill states that: "The Commission's [FCC's] jurisdiction is expanded, however, only to the extent necessary to empower it to adopt, administer, enforce, modify, or rescind provisions paralleling the substantive provisions of the decrees."

Unfortunately, this conception of a narrow jurisdictional grant is unrealistic and misleading. It cannot be achieved in practice. Consider what is entailed with the effective administration of the decrees. Suppose the FCC decides to allow local telephone companies to enter information service and long distance service markets. The decision will need to be accompanied by decisions regarding the proper telephone company corporate organization and the proper cost allocation rules dividing information service and long distance service activities from monopoly local exchange activities. As information services and long distance services begin to grow in importance for the local telephone companies, these rules will begin to substantially affect the level of local rates and the financial risks to which local ratepayers are exposed. A state regulator, having no authority over the long distance and information services, nor over the way costs are allocated between those services and local exchange services, will at that point have very little effective authority to assure that the provision of long distance and information services do not adversely affect the cost and quality of local exchange services. In the end, "narrow" FCC authority over the decrees will substantially affect the level of local rates and the financial risks to which local ratepayers are exposed, and significantly constrain state regulation.

It is not a sensible national policy to drastically alter the existing federal/state balance in telecommunications regulation in the effort to try to "give the regulation of the industry back to the regulators." The CPUC does not make this point simply as an empty effort to preserve "turf". Rather, it goes to the heart of the objectives of S. 2565 and whether they can be achieved. The basic problem with the jurisdictional framework of S. 2565 is that the FCC is not in a substantially stronger position to handle the consent decrees than is the District Court. Effective administration of the consent decrees, like telecommunications regulation in general, requires the resources and capabilities of the state commissions.

To administer the decrees, regulators will need to evaluate telephone company petitions to remove the prohibitions that the decrees place on their activities, such as the limitations on entry into interLATA long distance service, information services, and equipment manufacturing. Regulators will also hear from competitors in these markets that are worried about potential predatory tactics by the telephone companies. Further, regulators will hear from consumer groups that are concerned that telephone company diversification will expose them to higher risks and higher local rates.

To evaluate whether and in what form telephone company diversification into these markets should be allowed, regulators will need to do two things. First, they will need to analyze the nature of the market that the telephone company seeks to enter. Is it a competitive or monopoly service? If the latter, should there be some regulatory control over the telephone companies' activities? If it is a competitive service, what risks does telephone company involvement create for the company's basic local telephone business and its local ratepayers?

Second, if telephone company involvement is allowed, regulators will need to decide what kind of relationship should exist between the new venture and the company's local exchange operations. Should there be a requirement for a separate subsidiary? Should there be limitations on the financial exposure of the parent telephone company to the diversified activities of its subsidiaries? What should be the cost allocation rules governing the separation of activities between local exchange and the other diversified activities?

Both the FCC and the state regulatory commissions are capable of developing generic cost allocation rules to separate local exchange and diversified activities. But the state commissions are more capable at handling the other important questions listed above, in particular the analysis of markets. Markets in telecommunications vary significantly by region, as do telephone company strategies and capabilities. The market for packet switching services is far different in, say, the "Silicon Valley" in California than it is in, say, a rural part of Missouri. The entry of Pacific Telesis into the competitive Silicon Valley market will call for different rules than the entry of Southwestern Bell in rural Missouri, where it will be a limited monopoly service. Similarly, telephone company entry into long distance service will carry with it much different implications in a state with dense, high volume toll markets with significant equal access penetration that it will in states with less competitive rural areas and lower equal access penetration. Finally, telephone company involvement in markets now prohibited by the decree will carry with it different implications depending on the corporate organization of the telephone company, its business strategy, and its institutional capabilities. It may be quite legitimate to impose a structural separation requirement on a company with a persistent record of cross-subsidization while not doing so in the case of another company in another state or region.

State regulators are better able to address these issues because they are closer to the companies to which the consent decrees apply and to the markets that they seek to enter. State commissions have greater resources with which to tackle the complex questions arising from the administration of the decrees. The effective administration of the decrees will not simply require a few sweeping judgments about telephone company diversification. Rather, it will require expeditious and expert handling of a myriad or detailed, technologically complex questions about particular service markets ranging from protocol conversion to network software development to interLATA toll. As a practical matter, to undertake this effort the resources of the FCC are not substantially greater than those of the District Court and the Department of Justice. They are dwarfed by the resources of the state commissions. The telecommunications staff of the California Public Utilities Commission alone is nearly as great as that of the FCC. The FCC does not have the resources to undertake in depth evidentiary hearings of the kind that states regularly undertake (the FCC generally relies instead on rulemakings). Yet this kind of hearing will be required to analyze telephone company proposals to enter new markets.

If the jurisdiction over the consent decrees is transferred to the FCC, one of two developments could occur. First, the agency may attempt a thorough, case-by-case review of individual telephone company petitions to modify the decree. Second, the agency could choose to move faster by issuing some generic policies and rules to govern the decrees and telephone company efforts to modify the decrees.

Given the resource constraints of the agency, the first course of action is likely to create a cumbersome, slow moving process not unlike the District Court's waiver process. We therefore expect the latter course to be more probable. Unfortunately, this broad approach to the decrees is not likely to recognize differences between telecommunications markets across different regions nor between the telephone companies themselves. Further, the enforcement of any generic rules, such as cost allocation rules that protect against cross-subsidies, will be difficult at best for a single agency in Washington to achieve.

The FCC's recent Computer III decision is a relevant example of the weaknesses of this kind of generic rulemaking. The rulemaking dealt with telephone company involvement in "enhanced services", which can be considered identical to the information services addressed in the consent decrees. The basic thrust of the new FCC policy is to allow telephone company involvement in enhanced services on a non-structurally separated basis, to consider such services as competitive and unregulated, and to preempt any state regulation of intrastate enhanced services which is not entirely consistent with FCC policy.

While we generally support telephone company involvement in enhanced services, the FCC's policy is much too generalized and uniform to be an effective source of regulatory oversight over this form of diversification. It doesn't recognize the nuances. While we believe that structural separation should not be required for most enhanced services, it does make sense in certain instances (e.g., when this activity spills over into terminal equipment sales). Similarly, while some enhanced services are competitive and should be unregulated, many others are not. For example, many of these services, such as central office voice storage, should not be unregulated and "below the line"; rather, they should be regulated, become a part of the telephone company revenue pool, and a source of revenue contribution to keep basic telephone rates low.

In California we are generally supportive of telephone company involvement in new information services. The local exchange companies can potentially bring information services to a broader group of citizens at lower costs. But this involvement in new services is not without risks. It must be accompanied by careful regulatory scrutiny of the parent company relationship with the new ventures. Historically, our Commission has developed expertise with these questions as it monitored Pacific Telephone's relationship with AT&T and Western Electric. We now apply this expertise in cases where we have developed cost methodologies for new data services undertaken by the local exchange companies, cost allocation rules for Pacific Bell-Pacific Telesis affiliate relationships, and diversification guidelines for utility holding companies.

This kind of effort can continue and be expanded to cover questions related to the consent decrees. While we generally support the concept of a federal-state joint board to resolve technical, nonjurisdictional issues, we believe that it is essential that the issue of jurisdiction over intrastate matters be reserved exclusively to the states. Therefore, before we can consider supporting the basic goals of S. 2565, S. 2565 must be amended to expressly retain state jurisdiction over intrastate service under Section 152(b) of the Communications Act of 1934. For over 50 years the jurisdictional framework of the Act has worked reasonably well and has proven flexible enough to be adapted to industry changes. The existing framework also gives the FCC authority over telephone company entry into national or global markets now prohibited by the decrees, the states authority over entry into more localized intrastate markets, and a process of negotiation or court interpretations to handle the grey areas in between.

If Congress would like to rewrite the 1934 Communications Act and reformulate the current regulatory framework that grows out of the Act, it should do so directly and not as an adjunct to trying to solve another problem, namely, overinvolvement of the District Court in the day-to-day regulation of the industry via the consent decrees. We agree that the latter problem needs to be addressed and believe that it makes sense to give the oversight of the decrees to federal and state telecommunications regulators. But we do not think that the 1934 Communications Act should be indirectly rewritten at the same time, significantly changing the dual federal/state regulatory framework in telecommunications. To solve the consent decree problem while preserving the framework of the 1934 Communications Act we would support the amendment of S. 2565 with the single amendment that is attached for your review.

Mr. Chairman and Members of the Committee, thank you for considering the views of the CPUC on the important issues raised by S. 2565.

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